Comparison of the Treatment of Conflicts of Interest In Select Eastern European and Latin American Countries

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1 Introduction

Pension systems create an immense pool of money that is invested for many years before distribution to participants, providing a tempting wealth of resources often with little daily oversight and many people involved with the administration and management. Unfortunately, some people who handle pension plan assets may find it easy to borrow from or use these funds for their own purposes, frequently as stopgaps for their own cash flow problems. Some people believe plans can afford to pay excessive or unnecessary fees because the costs are spread thinly among so many participants. Administration and management of these pension assets requires proper supervision to detect a problem before it becomes too large to remedy, and laws must restrict the type of transactions that occur with plan assets, reducing the temptation to deal with them improperly. Ideally, the entire pension system must be secure enough to encourage increased responsibility in providing for one's own retirement needs, and reassure participants their money will be there when they need it, to reduce reliance on governmental resources.

A common risk to plan assets occurs when competing interests divide the loyalty of a party responsible for administration and management of the plan, creating a conflict of interest situation. Identifying these situations is the first step in creating a safe environment in which to invest for retirement. Pension supervisors discover conflicts of interest by understanding the nature of improper transactions and where abuses may occur, then utilizing all available laws—including tax, securities, insurance, and pension—governments exercise the necessary control and regulation of this growing industry. Weaknesses in existing laws illustrate the need for additional legislation to prevent, sanction, and deter misuse of plan assets. Legal redress must restore losses caused by misuse of pension assets back to the plans whenever possible. The combination of effective regulation, supervision, and redress protects pension plan assets and participants from many abuses stemming from conflicts of interest.

This paper focuses on the identification of potential conflict of interest situations through effective supervisory techniques, and examines possible regulatory gaps in existing laws. First, it provides an overview of a typical pension plan cycle, and compares the conflicts of interest rules and regulations of six countries–Chile, Costa Rica, Hungary, Mexico, Poland, and Slovenia—and examines how these would apply to typical conflict of interest situations, and unique conflicts that may present under those systems. It will also refer to United States pension law where applicable to exemplify certain conflict of interest situations, and the extensive conflict of interest regulations that have emerged. By reviewing actual conflict situations, supervisors and regulators understand the circumstances that lead to improper transactions or decisions, how to detect these situations, and where potential weaknesses in the current regulatory framework exist. The paper also addresses how non-pension laws might interact to complete a regulatory framework of pension supervision.

Of the six countries examined, the three Latin American countries provide only personal pension arrangements. That is, the employers' role is limited to forwarding contributions on behalf of the workers. The Eastern European countries have private pension systems that are occupational in nature, whereby the employers have additional plan responsibilities, providing more opportunities for potential conflicts of interest. In all the countries examined, the systems are or will be mandatory, partially replacing social security, so the concern over conflicts of interest is increased. In the United States, the private pension system is voluntary.[2]

1.1 Reasons to Regulate for Conflicts of Interest

The reasons for avoiding conflict of interest situations are obvious. Conflicts of interest can lead to improper transactions that reduce available plan assets, leaving a smaller pool of money to pay benefits and invest with. It not only depletes the available assets directly, but also lowers the potential return on plan investments. Even the appearance of a conflict may hurt the system if it causes participants to lose confidence and are less willing to join plans or invest sufficient portions of their earnings. Participants and beneficiaries suffer with reduced earnings and benefits, and in extreme instances, a complete loss. Most people have limited resources during retirement to earn adequate income to pay normal living expenses, so lost benefits expose governmental agencies to increased spending on subsidies for retirees. Governments already stretched thin on resources must pay benefits to allow citizens at least a modicum of income to meet their daily living requirements.

1.2 Responsibility for Regulation

Primary responsibility for pension plan supervision rests with government authorities for many reasons. Participants' self-sufficiency in providing adequate retirement income reduces reliance on governmental resources, so confidence in the system directly benefits the government. In addition, single participant losses due to improper transactions may be minimal, making enforcement on an individual basis less cost-effective even though aggregate plan losses may be extensive. A conflict of interest typically affects many accounts rather than just one, and generally, the average participant lacks the requisite knowledge and financial expertise to identify problems in pension plan administration. If each participant harmed by a conflict of interest sought restitution for losses, the results may be inconsistent from one case to the next, causing disparity among treatment of plan participants and encouraging increased litigation. Plans would spend excessive time and money answering and defending allegations of improper conduct, causing increased costs to the plan and participants in administrative fees, affording less time on effective asset and plan management, and at the end of the day, costing the government in subsidies because the plan was unable to increase in value as needed.

Government responsibility for pension oversight is generally shared among many different departments and agencies. Typically, the labor and social welfare ministries have primary authority for rule making and supervision of plans and their design, probably because they are charged with subsidizing the welfare of the citizens if retirement benefits are insufficient or absent.[3] The taxing authority sanctions plans for certain types of improper administration and management by disallowing tax deductions and incentives if regulations are not followed. The

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[2] In the U.S. system, the employer determines whether a pension plan will be offered for its workers. Some employers may make participation in the pension plan a condition of employment, but the overall determination of whether to offer a private pension plan is left to each employer.

[3] Some governments have instituted separate agencies for this supervisory function.

securities agencies oversee the investment and management of plan assets invested in publicly traded equity and debt instruments, while the insurance regulators supervise annuity contracts and insurance product investments. Finally, the judicial system provides the arena for redress, both civilly and criminally, if violations of the law occur and losses must be restored.

Many institutions and service providers also offer supervisory protection for plans. Banks, brokerages, insurance, and pension companies can notify the proper authorities if assets appear at risk, in addition to preventing conflicts of interest through proper corporate governance. Service providers can terminate an arrangement with a mismanaged plan, essentially notifying participants that problems exist and allowing market forces to compel compliance. Labor unions ensure workers are adequately represented, particularly at the plan's inception, and collectively if there are violations that affect the participants as a whole. By protecting participant rights during the plan design phase and structuring the plan contract appropriately, many conflicts of interest can be prevented altogether. Professional service providers and organizations, such as accountants, attorneys, and actuaries, possess the experience and knowledge to detect inaccuracies and improper management of plans and their assets earlier in the process than regulators or asset custodians. By following mandated codes of professional conduct, many conflicts are avoided or voluntarily corrected before they threaten plan assets. Finally, the individual participants can watch their own accounts for problems, and notify pension supervisors if they observe improper activity.

2 Overview of the Present Systems of Governance

Similarities exist in the multi-pillar structure of the pension systems in the six represented countries, and in the typical cycle of a pension plan from contribution to distribution.[4] The process begins when a plan sponsor, often an employer, offers a pension plan to participants, who are usually workers.[5] The terms of the plan are established before its inception, a process that may fall outside the regulatory authority of the government. Once the terms of the plan are decided, a plan contract is prepared that contains all the provisions of that particular plan, including eligibility to participate, to contribute, and to receive benefits and distributions, and identifies the plan administrator, the pension company, and investment strategy for the plan. Workers participate by having their employer withhold a portion of their wages for investment in the plan. In some plans, the employer contributes on behalf of the workers from the company's general asset account, or matches the participant's contribution with an amount equal to some proportion of the worker's wages or contribution. Regardless of the source of the contribution or who sponsors the plan, responsibility for remitting participants' contributions to the pension or investment company typically rests with the employer.

Administrative responsibility shifts in many directions as more and more people and entities are involved in the management and custody of these pension plan assets. The number of

[4] Diagram 1 provides an overview of a typical pension system and the regulatory agencies responsible for its supervision.

[5] The Latin American countries do not have employer sponsored plans, but employers do pay contributions on behalf of the workers to the pension plan provider the worker has chosen. The Eastern European countries allow employers to sponsor these plans, typically in a closed pension plan arrangement.

parties with access to the pension assets depends greatly on the investment strategy and portfolio of the particular plan. For instance, the plan administrator instructs the pension or investment company to use plan assets to buy securities, annuities, real estate, or make loans with plan assets, in accordance with the plan contract and for the exclusive purpose of increasing the wealth of the plan to provide the greatest return for participants. Plan administrators retain investment managers to manage, acquire, and dispose of plan investments; investment advisors to suggest appropriate investment products for the plan portfolio; or they perform these functions themselves. The overarching goal in pension administration is increasing net return on investments sufficiently to ensure participants' accounts retain the initial value of the contributions, pay plan expenses, cover inflation and cost of living increases, as well as grow to provide an adequate income to pay living expenses during the entire retirement period. To that end, some impose a minimum guaranteed rate of return on pension plan investments, such as Slovenia.

Pension companies sometimes serve as plan administrators, ensuring plan assets are properly allocated to participants' accounts, carrying out the investment instructions from the investment manager, paying fees to service providers, and calculating and remitting distributions to participants who qualify for withdrawal, either upon retirement or to join a different plan. A pension company could be a private corporation with its own board of directors and shareholders, or owned by the participants who elect the board from the participant members. A supervisory committee may also oversee the operations of the board and the company itself. The salaries and expenses of the board and committee members are paid from plan assets, as are all the other above-mentioned financial obligations stemming from plan administration. The plan administrator may contract with outside service providers or consultants for specialized purposes, or expertise. For example, an independent accountant might render an opinion on the overall financial soundness of the plan, the pension company, or to audit the financial reports provided by the plan administrator. An attorney may advise the administrator regarding regulatory or other legal aspects of plan administration, or interpret relevant rules and regulations. If the plan invests in insurance products, an actuary would determine necessary funding levels of annuity contracts to ensure sufficient assets will be available to participants upon retirement. Other consultants may provide discreet and highly specialized services, which are paid out of plan assets and can be expensive.

The responsibility for plan administration and asset management only ends with the final distribution of benefits back to the participant, thereby completing the pension system cycle and placing responsibility for a participant's money back into his or her own hands. Until that benefit is paid, many avenues for conflicts of interest arise, increasing with each additional person handling the assets. While the participants' money is in the possession and control of others, the potential for misuse, abuse, and even complete loss of the monies exists. Compound this by centralizing the financial market of a small country into a single geographic region, narrowing the playing field of available pension experts and service providers, and one quickly realizes that a conflict of interest may be more likely than not to occur.

Although this synopsis presents an overview of a typical pension cycle, variations among countries obviously exist. Following is an examination of the six countries in detail, highlighting their unique organizational structure and regulatory requirements for pension plans, and providing the framework for examination of some common conflict of interest situations that can arise in each pension system.

2.1 Chile

Chile has one of the most seasoned private pension systems, and its three-pillar structure is often used as a model for other countries. Participation in second pillar pension plans is mandatory for workers who have entered the labor force since 1993, so employers collect contributions and remit them to individual participant accounts held by private plan administrators known as Pension Fund Administrators (AFPs). AFPs, which are structured as joint-stock companies, can be created by any group of shareholders provided the exclusive purpose is managing pension assets on behalf of the participants.[6] The AFP invests pension plan assets in capital markets on behalf of participants, though pension funds, which are not legal entities, manage the individual accounts of plan participants, as well as the voluntary savings and compensation accounts (used to supplement the primary pension plan), and invest the assets accumulated in those accounts for the participants' benefit.[7] Participants invest in only one plan at a time, but not all workers of one employer must be invested with the same AFP, so the worker chooses which AFP he or she wishes to invest with, creating competition to attract participants.

AFPs must ensure the "adequate profitability and safety of the investment of the funds they manage," in addition to monitoring the performance of the entities in which they invest plan assets. They have a duty to avoid conflicts of interest between themselves and the plan participants, including keeping the assets of the AFP separate from the pension plan assets, thereby safeguarding them from any potential creditors of the AFP, or from liquidation in the event of a bankruptcy. The AFPs charge fees for depositing the participants' regular contributions, for transfer of any participants' assets to another AFP, on payments of temporary income (similar to loans), and for processing scheduled withdrawals. These fees are based on a percentage of the contribution, as a flat rate, or as a combination of both methods, and typically do not exceed two to three percent of the participant's wages. Although the AFP can freely set its fee structure, it must be applied equally to all participants.[8] Finally, to avoid even the appearance of a conflict, all transactions must be carried out in recognizable markets to ensure adequate transparency and supervision. The Chilean pension law mandates daily valuation of publicly traded securities based on the closing market value, and non-publicly traded assets based on Superintendent of Pension Funds (SAFP) guidelines.

[6] Free entry into ownership of AFPs is allowed provided certain minimum capital requirements are met; the greater the number of participants, the higher the capital requirement. Foreign investors can have ownership interests in AFPs.

[7] They can also provide consulting services to foreign pension plans, participate in the ownership of fund-management companies, and own companies that provide services to the Chilean public pension system, such as the Central Securities Deposit.

[8] There is an exception to this requirement for self-employed individuals and those not requiring survivorship or disability insurance that participants must also purchase from the AFP they invest with.

AFPs guarantee a minimum return on investments for participants, which is based on average returns industry-wide.[9] However, as in many systems, the government remains the "insurer" of last resort, and will subsidize a minimum pension for individuals who have not accumulated sufficient funds in their account to finance a pension at the minimum amount prescribed by law. The AFPs are required to maintain cash reserves equivalent to one percent of the total value of the pension plans under their control, which is paid from the general assets of the AFP, and not from participant contributions, and used to fulfill the minimum yield requirements if the AFP does not maintain a fluctuation reserve. If these reserves still do not meet the minimum return requirement, the government subsidizes the remainder and proceeds to wind down the AFP.

Although there is considerable regulation on the diversification of plan investments, the extent of permissible securities' investments is wide. Pension assets must be invested in publicly offered securities that are registered in a specified list of exchanges. To prevent potential conflicts of interest between AFPs and the plans they administer, AFPs are prohibited from investing in any securities on its own behalf that may be acquired by the pension plans. There are also strict limitations on investments in companies related to the AFP, such as a five percent maximum percentage of plan investment. AFPs cannot exert influence on companies they invest pension assets in, which includes voting to elect board members if the candidate is related to a majority shareholder or anyone with substantial control in the AFP.[10] The Central Bank is required to have physical custody of 90 percent of all securities invested by each pension plan.

Actuaries and auditors are the primary service providers to Chilean pension plans. Actuaries are responsible for ensuring the pension benefit provided remains close to the income level the participants receive prior to retirement, in addition to making a determination regarding adequate plan funding. External plan auditors must be selected from those registered with the Superintendency of Securities and Insurances (SVS) under securities law, and are liable for any damage caused by their actions, reports, or omissions. The SVS has the authority to censure, fine, and/or revoke the license of these registered auditors. One requirement for registration is a listing of all audit customers, possibly to uncover any potential conflicts of interest before they occur. Accounting/auditing standards are regulated by both law and professional codes of conduct,[11] including the Accounting and Auditing Board of the Chilean School of Accountants. Chile is also considering the gradual implementation of the International Accounting Standards (IAS) and Generally Accepted Accounting Principles (GAAP).

The SAFP regulates the pension system, primarily the AFPs, and falls within the authority of the Ministry of Labour and Social Security. This agency oversees the process of AFP creation,

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[9] AFPs evaluate the actual yield on a monthly basis by examining the return on all the plans they administer for the previous twelve-month period.

[10] The Superintendency has also ruled that AFPs voting together as a block is unacceptable, with an exception for board member elections with explicit authorization. The Antitrust Prosecutor has enforced this position, stating that this and other joint acts by AFPs might constitute intervention with the management of the companies in which pension assets are invested.

[11] Government regulations can be found in the Code of Commerce, Tax Code, securities, corporate, and insurance law, and banking and financial institution regulation.

including approval of by-laws and final authorization of the entity. Additionally, the SAFP supervises the AFP's compliance with legal, administrative, and financial regulations, as well as minimum capital and cash reserve requirements. These regulations include proper investment of pension assets, and oversight of internal operations such as distribution of benefits, collection of contributions, transferring accounts between AFPs, recovery of late payments, and collection of commissions. If an AFP is found to be in violation of Chilean law, the SAFP has authority to levy fines, and decommission an AFP in extreme cases.

2.2 Costa Rica

In February 2000, the Costa Rican National Congress passed the Workers' Protection Law that created a supplemental private pension system, and adopted a multi-pillar system including a mandatory social security pension benefit, a mandatory supplemental defined contribution system, a voluntary individual supplemental system, and an anti-poverty non-contribution system managed by the government. The Superintendencia de Pensiones (SUPEN) has regulatory oversight of these plans. Contributions to the second pillar are mandatory for both employer and worker, and taken directly from wages, while third pillar plans are open and voluntary, with benefits paid in the form of lump sums or annuity contracts, and either sponsored by an employer or non-sponsored. There are no guaranteed rates of return in either of these pillars, so participants bear the entire investment risk although the government does insure the assets against insolvency of the management company. Second and third pillar plans can be sponsored and administered by private pension fund managers, *operadoras*, who are licensed by the regulatory authority, subject to minimum capital and annual reporting requirements, and operated as separate legal entities with segregated assets.

The *operadora* administers the pension plans for the benefit of the participants, and each participant owns a proportional interest in the value of the plan assets. Regulations establish maximum ratios for specific categories of investments, thereby encouraging diversification while reducing the likelihood of conflicts of interest. The *operadora* provides individual account management services, including record keeping, asset management, and benefit payments. They purchase and manage a portfolio of securities, then enter into a contractual agreement with participants who purchase an interest in a portion of the portfolio. Contributions to the pension plans are collected along with contributions to the social security system, using the Costa Rican Institute of Social Security (SICERE), which is a centralized collection agency. SICERE collects the contributions and then remits them to the appropriate *operadora* on behalf of each worker. Pension benefits are paid either in the form of an annuity from the *operadora*, or through an annuity contract with an insurance company. Insurance companies providing annuities come under regulation of Costa Rican insurance law, while accountants and auditors are subject not only to the national laws, but also partially to the International Standards on Auditing (ISA), which were adopted by Costa Rica in part in 2001.

2.3 Hungary

In 1997, Hungary created a multi-pillar pension system, including a mandatory, social security pension provided by the government, and a series of fully funded pension plans that provide a life-long annuity at retirement. All contributions to the second pillar come from individual participants and are now mandatory for new entrants into the work force. Second pillar plans must guarantee a minimum rate of return on investments, specified by the government on an annual basis, for which plan administrators maintain a fluctuation reserve to maintain investment returns during periods of below-average earnings. If the reserves are depleted, participant contributions and above-average investment returns replenish them. When retirement benefits are paid, the plan administrator chooses whether the annuity is paid from plan assets, which requires an increase in the reserve account, or by purchasing an annuity contract from an insurance company. The third pillar is a voluntary supplemental pension system that allows individuals to increase their retirement income earned under the first two pillars, and gives employers who sponsor these plans tax incentives. The institutional structure is similar to that of the second pillar, except that individuals can sponsor their own plan and no guarantees of a minimum rate of return exist.

Second and third pillar plans are structured as mutual savings associations, with ownership rights vested in plan participants.[12] Participants exercise their rights in the plan through a General Assembly that approves plan provisions and modifications, elects and removes members of the Board of Directors and Board of Supervisors, and determines Board member salaries. The Board of Directors determines the plan's overall business policies, and ensures that plan records meet legal requirements. This Board also hires a Managing Director and an Expert Committee, comprised of a chief accountant, investment manager, plan asset custodian, actuary, auditor, legal expert, and internal inspector; plan activities cannot commence until the Board fills these positions. The Board of Supervisors regularly reviews the plan's finances, and makes annual reports on such to the General Assembly. The Managing Director, as an employee of the plan, implements Board resolutions, and must continuously operate the plan in a profitable manner. The operation of a second or third pillar plan first requires a sponsor to obtain a foundation license, followed by the State Fund Supervisory Board issuing an operational license.

Due to the system's structural requirements, plans use many outside service providers who owe a duty of loyalty to the plan: accountants, actuaries, attorneys, auditors, custodians, and investment managers. Auditors examine all reports and financial data for accuracy and compliance with governmental regulations, and provide an opinion as to these matters. Actuaries supplement the auditors' work by counter-signing the financial plans and reports, providing statistics, and attesting to the soundness of information provided to the board of directors. Custodians monitor the other service providers, and keep current records of investment activities. They must warn the board if execution of a specific transaction could jeopardize the plan's interests, and can refuse to carry out an adverse transaction. Insurance companies provide life-annuity contracts to participants if the plan administrator chooses this method of paying pension benefits. The Hungarian Financial Supervisory Authority (HFSA) has authority to promote, mandate and protect investors in financial institutions, including authority over "organizations, persons and activities" covered by the Act on Private Pensions and Private Pension Funds, such as pension plans, plan sponsors, service providers, and organizations providing supervisory services under the second and third pillars.

The Hungarian pension law addresses conflicts of interest by prohibiting self-dealing transactions, preventing parties with an apparent conflict of interest from holding certain positions

[12] See Diagram 2 showing the management structure of the mutual savings associations.

with the plan, and charging every person acting on behalf of the plan with a duty to act with great care in the interest of the participants. Very specific conflict of interest prohibitions ensure independence of the auditor, and prohibit persons with an ownership interest or business relationship that is contrary to the safe operation of the plan from serving as senior officers or employees.[13] For example, a senior officer elected or employed by another plan, investment enterprise, financial institution, or insurance company, must disclose this immediately to the current plan's board of directors and the Private Fund Supervisory Board. The same is true if an officer terminates such a position, or obtains an influential share or right to vote in any of the same entities. Custodians cannot provide any other services to the plan, or hold more than 10 percent in any other economic interest incompatible with its duty to monitor the plan's service providers. Investment managers cannot serve as officers or senior employees of the plan's custodian or any other entity that may give instructions regarding custody of plan assets. Further, senior employees of officers of the custodian, or any other person with management duties of the custodial entity cannot invest or manage plan assets.

Investment diversification rules also prevent some potential conflicts of interest. Plans cannot invest more than 10 percent of its assets in securities issued by the same issuer, and mandatory plans cannot invest more than 20 percent of its securities with the same banking group. Plans cannot invest in the plan sponsor's business or in any other employer of any plan member, or in any entity in which a service provider owns more than a 10 percent interest.[14] Of all the countries examined here, Hungary provides the most extensive and specific regulation of conflicts of interest.

2.4 Mexico

In 1995, the Mexican Congress passed legislation establishing a new, fully funded pension system with individual accounts that divided social security insurance into several benefit categories, and created a three-pillar pension system. The first pillar provides a minimum guaranteed pension that is publicly managed and equal to the indexed minimum wage for low-income workers. The second pillar consists of a fully funded, private, individual account system with competitive mutual fund management funded through contributions by employees and the government. Participants choose a private Pension Fund Administrator (AFORE) to administer and invest their individual funds, which they can change annually or whenever the AFORE changes its fee structure or investment policies. The third pillar is a voluntary supplemental contribution scheme.

The Pension System Law provided the current regulatory framework for the establishment, operation, and supervision of pension plans, and created the specialized mutual pension funds

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[13] Parties serving in other plan capacities or their close relatives are prohibited from serving as an auditor to the plan. The law also states integrity of plan operation would be "jeopardized if the activities and/or influence of the potential senior officers endangered the independent, reliable, and thorough management of the plan." This also occurs when the nature of the business activities of the potential senior officer hampers the management and control of the fund.

[14] An exception to this exists if the service provider if founded, or partially owned, by the plan.

called SIEFORES, are separate legal entities with their own Board of Directors and managed by the AFORES.[15] This law also granted CONSAR, the National Commission for Retirement Saving Systems, power to create and enforce rules for the operation of the reformed pension system. CONSAR has full supervisory authority over the AFORES and the SIEFORES, and supervisory power over third party service providers, such as banks and insurance companies. It issues regulations, conducts investigations, and levies fines in this capacity. CONSAR also has administrative and management intervention authority of AFORES and SIEFORES if needed, and can revoke the authorization of any AFORE or SIEFORE not in compliance. CONSAR oversees reconciliation of contributions with payroll records; the transfer of monies into the individual pension accounts; the sales practices of SIEFORES; and ensures these funds comply with pension regulations. The Social Security Agency (IMSS) is responsible for collecting payroll contributions, and depositing them into an account at the Central Bank prior to being forwarded to the investment accounts. IMSS also guarantees a minimum retirement income amount, and subsidizes any shortfalls.

Each AFORE is a single-purpose corporation whose establishment requires authorization from CONSAR, who grants or denies an application at its own discretion after examination of the AFORE's business plan, shareholder composition, control, and corporate management. A ceiling limit of 20 percent of the market share can be managed by a single AFORE. AFORES can set fees without limitation, although CONSAR issued regulations on the fee structure that AFORES use, either based on a percentage of assets under management, a percentage of contributions made, or some combination thereof. Under the current laws, CONSAR must approve all members of the board of directors, as well as the general director and the compliance officer for each AFORE, based on moral integrity, technical competence, and managerial expertise. Further, CONSAR has authority to remove any director, officer, or compliance officer found lacking any of those qualities.

Although there is no minimum return guarantee requirement, specific rules regarding diversification of investments of the SIEFORES ensure stability. Initially, pension assets were invested in government debt instruments, but under the current laws, SIEFORES only invest in securities that are well rated by private rating agencies and approved by CONSAR. This encourages publicly traded companies to provide better corporate governance through accurate accounting, transparency, and disclosure. To ensure that AFORES do not abuse their position as investment managers, there are strict limitations on transactions between AFORES and affiliated financial institutions and issuers. Regulations prohibit a SIEFORE from investing more than five percent of its total assets in entities that have a management or shareholder relationship with the SIEFORE, and there is a clear distinction between SIEFORE and AFORE assets that offers greater security to the pension assets. The SIEFORE actually belongs to the participants, who then empower the AFORE to administer their pension funds. The AFORE belongs to a group of stockholders who cannot use participant funds to finance other ventures. AFORES are required to invest their capital reserves in the funds they manage to minimize conflicts of interest by fund managers. This strategy aligns the interests of all the parties.

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[15] This structure is similar to the mutual fund in the U.S. system.

2.5 Poland

The Polish Law on the Organization and Operation of Pension Funds of 1998, amended in 2000, creates a three-pillar public and private pension system. The first pillar is a mandatory contribution system of social security insurance; the second, a mandatory contribution system for investment in private funds with individual participant accounts; and the third, a voluntary supplemental pension system where employers sponsor plans called "employee pension programs" (PPE) if they meet certain conditions and follow prescribed requirements.[16] A worker can participate in more than one PPE if employed by more than one employer, and two or more employers can establish a multi-employer PPE under certain conditions.

The PPEs can be structured as a pension fund, investment fund, or insurance program. The pension fund PPE is designed specifically as a mutual pension fund, sponsored by either an employer or an asset manager. A group of individuals, called a pension society, representing both employer and workers, administers these funds with equal responsibility. This society can hire an outside administrator and delegate their function to that entity, or retain the administrative responsibilities. The society itself is a non-profit corporation provided it collects fees of less than .06 percent of the plan's assets per year. These fees pay overhead expenses, members' expenses, brokerage fees, and fees paid to the outside administrator. The employer plan sponsor would pay any fees exceeding this amount. A management company controls the investment fund PPE, and may have a menu of investment choices for participants, rather than a single fund option. Participants select one of these funds for his or her investment choice, but can transfer the entire balance to a different investment if desired. The insurance fund PPE invests in products offered by insurance companies. The insurance company must establish a separate account for the collection of contributions from participants, but can then invest in its own or outside funds. All participants of one employer receive the same product at the same cost from a risk-diversified selection of investment choices, except benefits based on salary.

Pension plan supervisory authority rests with the Superintendency of Pension Funds (UNFE), which is charged with ensuring the safe and effective management of pension plan assets and providing enhanced protection for workers, specifically of third pillar pension plans. Within this agency various departments exist with specific oversight functions: the Supervision Department, Legal Licensing Department, Department of Financial Policy, Research and Social Communication Department, and the Department of Employee Pension Programs. Supervision of insurance products rests with the State Insurance Supervisory Office, which is responsible for protecting the interests of insured persons and preventing situations where the insurance company cannot provide the benefits promised. This office oversees insurance companies and brokers who sell insurance products. It also issues licenses for insurance companies and brokers, as well as provide regulations regarding the conduct of these businesses. The Polish Securities and Exchange Commission (KPWiG) supervises the trading of public securities and the commodities exchange.

2.6 Slovenia

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[16] One such requirement is negotiation of a company pension agreement (ZUE) with the workers.

The Pension and Disability Insurance Act of 1992, and amended, established a three-pillar system that was later amended to a two-pillar system where Pillar Two pension benefits come in two forms: individual pension plans and collective plans sponsored by employers. Plans can be structured as mutual pension funds investing in securities and managed by an operating company, or as a pension company investing in insurance products. Employers, workers, or both, can contribute to the plan, qualifying for tax relief against profits for the employer, and deferred income for the worker. If an employer sponsors a plan, it must pay all or part of the contribution on behalf of the participants. If workers also contribute, the plan must be entered into through a contract between the workers and employer, or conform to any collective bargaining agreements covering those workers.[17]

The plan contract must disclose specific information to obtain approval from the Ministry of Labour, Housing, and Social Security, including the contribution amounts and penalties for non-payment. Upon retirement, the plan administrator, who is either the mutual pension company or the operating company, purchases annuities for the benefit of the retiring participant, which are paid to the plan administrator for distribution to the participant or directly to the participant.[18] Participants in mutual pension funds choose the annuity provider when they become eligible for retirement benefits, while participants in pension companies may be required to purchase their annuities from the pension company or may be given the opportunity to select a company from a prescribed menu of annuity providers. Plans guarantee a minimum rate of return on investments equal to 40 percent of the average annual interest rate on long-term government securities. If the actual return of the investments exceeds this amount, the plan administrator puts the excess into a reserve account. If the return falls below the guaranteed return, the administrator can use this reserve to pay the shortfall, but the reserve account cannot exceed ten percent of the net asset value of the fund. If the reserves are insufficient to pay the full difference, the administrator must pay any outstanding amounts from his or her own assets into a separate cash account within 15 business days of the end of the quarter. The plan administrator performs these calculations quarterly.

The Securities Market Agency supervises mutual pension funds and operating companies, including authority to liquidate a fund if the annual membership falls below 1000 participants or the asset value falls below a certain threshold. Participants own the mutual pension fund, which can be open or closed, in proportion to their contributions, and either a bank or an insurance company act as the operating company.[19] The operating company collects contributions from the employer or participants, keeps the records of the participants' accounts, manages the assets, and pays distributions, however it can contract with an approved asset management company to manage the plan's investments, and in fact must do this for closed funds it sponsors for its own

[17] The represented union then enters into the pension plan agreement on behalf of the employees.

[18] Lump sum payments are not allowed except in the case of "extraordinary termination" of plan participation or liquidation of the plan administrator. The plan contract must state which of the alternatives will be used.

[19] Operating companies can administer open-ended funds sponsored by them, or a closed-ended fund for its own employees. If an employer sponsors the mutual pension fund, it must contract with an operating company to administer the plan.

workers. The plan administrator must keep assets of the mutual pension fund separate from the assets of the plan sponsor as well as from any other pension fund under its administration.

Pension companies can also establish pension plans, and although a mutual pension fund is not a legal entity, a pension company is. Operated as a joint-stock company, it comes under the Insurance Supervision Agency authority in accordance with the Insurance Act, and cannot provide any services unrelated to supplementary voluntary pensions.[20] These services include collection of contributions, asset management, account record keeping, and payment of pension annuities, but it can contract out these operations to another pension company. Pension companies must retain reserves equal to one-third of the minimum capital requirements set forth under life insurance laws, but no less than the level of guaranteed capital required by the same law for this company. A management and supervisory board govern pension companies, and no member can be associated with any entities that the pension company has a greater than five percent interest in.[21] The supervisory board approves certain decisions of the management board including the overall business policy of the pension company, its financial plan, and institution of internal control systems. Additionally, the supervisory board determines the adequacy of the company's internal controls, provides a substantiated opinion of the annual and financial reports, and an opinion to the general shareholders on the internal auditor's and management board's annual reports. The supervisory board, one-third of which must be appointed by proposal of the participants, appoints the members of the management board, which must consist of at least two full-time, permanent members who represent the company legally. No one member can independently represent the company in its "full scope of operations." Management board members must report certain circumstances to the Insurance Supervision Agency, and collectively, the board must report if the liquidity or solvency of the company is threatened; reasons for a revocation or withdrawal of authorization to act as a member or pension company; reasons for any prohibitions in the company's performance as an individual insurance business; and adverse financial changes and failure to achieve minimum reserve requirements. Individual members must also report appointment or withdrawals of members from other supervisory boards, and any financial transactions that exceeded the qualifying holding limit.

3 Examples of Conflict of Interest Situations

A conflict of interest, in its basic sense, exists in every transaction involving plan assets, whether cash, securities, or property, moving either in or out of the plan's portfolio. Every transaction benefits someone outside the plan with a concomitant cost to the plan. For example, paying fees to a service provider benefits the service provider by providing him with income, and depletes the plan of assets. However, many services are reasonable and necessary for proper plan administration, so governments make exceptions for certain transactions. Lending plan assets

[20] Shares of ownership in the underlying pension company must be acquired pursuant to regulations set for under insurance law, specifically of joint-stock companies.
[21] The Articles of Association of the pension company describe the method for appointment, and enumerate the basic principles and restrictions on plan investments, fee structures, service providers to whom authority to administer any functions of the pension company have been transferred to, and method for calculating account balances.

benefits the borrower by increasing his cash flow, and increases the risk to the plan that the monies will remain unpaid, but risks are necessary to make gains. Purchasing securities generates fees and commissions while improving the stock performance of the underlying company, but depletes the plan of cash for the initial purchase, and creates the risk of losses to the plan on every purchase. Paying pension benefits to a retired participant provides that participant with income but reduces the plan assets available for investment. Even the receipt of contributions to the plan is not without conflict, such as whether the funds were remitted in a timely manner. Although this is a drastic view of the potentiality of conflicts of interest, it serves as a starting point for an examination of how conflicts arise. Each government must then decide at what point the costs and risks of the conflict outweigh the anticipated or expected benefit. At this point, they must draw the line of acceptable conflicts versus unacceptable.

A full examination of whether a situation rises to the level of being a conflict of interest is not complete without addressing whether the underlying decision or transaction is prudent and in the best interest of the plan and its participants. The prudence of any transaction can only be determined after a full examination of all the related facts and circumstances. Prudence demands due diligence in plan administration, proper oversight of delegated functions, and expertise commensurate with duties. Acting in the best interest of the plan and its participants is only slightly easier to define. Under U.S. law, it is termed the "exclusive benefit rule," and involves two factors: making decisions or carrying out transactions for the "exclusive purpose of (i) providing benefits to participants and beneficiaries; and (ii) defraying reasonable expenses of administering the plan."[22] Combining a prudence standard with the exclusive benefit purpose provides the standard of whether a transaction or decision is a conflict of interest, even if the transaction has inconsequential collateral or incidental benefits that inure to a third party.[23]

During the past several years, global economic events brought to light many conflicts of interest between private companies and the participants in pension plans, including Enron, WorldCom, and Global Crossings. Previously believed to be sound, the plans sponsored by these entities were actually at great risk, much of it brought about through the underlying conflicts of interest within the sponsoring entities that had developed over many years. One school of thought suggests financial irregularities and fraud start out as little more than over-zealous accounting practices, but over time, and in an effort to conceal the previous irregularities, the misreporting grows to unprecedented proportions, eventually affecting the plan directly or indirectly through the financial failing of the companies in which it is invested. While these are dramatic extremes of conflicts of interest, more subtle varieties also exist.

Conflicts of interest appear in three forms—actual, potential, and apparent, meaning the appearance of a conflict of interest exists even if no potential or actual conflict does, and they stem from a variety of circumstances. Some arise when regulated duties conflict, such as a director's duty to maximize profits for shareholders competing with her duty to minimize administrative fees

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[22] ERISA Section 404(a)(1)(A) in pertinent part.

[23] This definition does not necessarily apply to self-dealing transactions involving plan officials. The conflict of interest is so great in those instances that a higher level of scrutiny must be placed on them, not only to address actual conflicts, but also to avoid the appearance of conflict.

to plan participants. Some conflicts emerge when a plan administrator must decide whether an action should benefit one participant over another. The third variety comes from self-interest versus duty of loyalty, as is the primary focus of this paper. Actual conflicts are evidenced by transactions or decisions that cause losses to a pension plan, while potential conflicts lay the foundation for a future loss. The self-interested variety can benefit the person making the decision directly or indirectly, or can benefit a third party similarly. The appearance of a conflict raises suspicion regarding the integrity of plan administration and undermines public confidence for investing, or perhaps in the entire pension system. For this reason, many countries outright prohibit certain categories of transactions, thereby thwarting not only potential and actual conflicts, but the appearance as well.

3.1 Conflicting Duties

Recently, participants in the WorldCom pension plan, and similarly with the Enron case, filed a lawsuit alleging the plan administrators engaged in a conflict of interest by "encouraging employees to invest their pension funds in WorldCom stock without disclosing that . . . WorldCom's true financial condition was unstable and an imprudent investment."[24] Simply stated, the officers and directors of WorldCom encouraged participants to select its stock for investment despite the officers' personal knowledge that the company was experiencing financial distress.[25] By having participants invest in its stock, the market price was stabilized and the outward appearance of financial stability within the company was suggested, leading outside investors, vendors and creditors to presume WorldCom was a safe and viable corporation because employees themselves were investing in it.

WorldCom had conflicting duties of loyalty by wearing several "hats" as plan officials, plan sponsors, investment advisors, and corporate officers of the underlying investment entity. Through their corporate positions, these parties had knowledge regarding the financial stability of the company whose stock was offered for investment, which substantially affected its value. Despite this knowledge, they encouraged participants to continue investing in the stock, and failed to remove it from the available investment options for the plan. Likely, part of their compensation package included performance bonuses based on the profitability of WorldCom, and retention of their corporate positions hinged on the continued operation of the company. Finally, they controlled and deliberately concealed the financial distress of the company whose stock was offered, possibly moving this from a civil violation to a criminal act.

A similar situation could arise within the Chilean system. AFPs, which are structured as joint-stock companies, can be created by any group of shareholder provided the exclusive purpose

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[24] *Rambo v. WorldCom Inc.*, S.D.Miss, filed 27 June 2002. The complaint alleges WorldCom reported operating costs as capital investments, hid expenses, over-reported cash flow, and showed the company as profitable, when it was experiencing losses. When WorldCom eventually disclosed the over-statement of cash flow, stock prices plunged. Many of the facts presented here are yet unproven, but are offered as illustrative of potential conflict of interest situations. WorldCom plan participants chose investments for their individual pension portfolio from a menu of options, and one of the choices was WorldCom common stock.
[25] BNA Vol.29, No.27, p1880.

is managing pension assets on behalf of the participants. These shareholders have at least two areas of inherent conflict: the self-interested conflict of retaining their positions, and the conflicting duties of maximizing profits for shareholders while keeping costs down for plan participants. This is further enhanced by the cash reserve requirement that must be paid from AFP assets. Shareholders will not want to contribute to this from their personal finances, but the law demands it. Finally, if the AFP cannot invest in the same entities as the pension plans, AFP shareholders must choose whether to retain the better investments for themselves of for the plan participants.

This situation is less likely to arise in the Eastern European countries as they have adopted regulations prohibiting plans from investing in the companies of sponsoring employers.

3.2 Failure to Remit Contributions Withheld from Wages

The US pension system contains a provision under the Internal Revenue Code whereby employers sponsor deferred compensation pension plans known as 401(k) plans, referencing the provision in the Code that allows this. These plans have been the target of governmental supervision for over seven years as the conflict of interest situations mount. Missing and delinquent contributions of wages into the pension plan, along with the lost earnings on these monies, amount to millions of US Dollars every year that should rightfully be invested as pension plan assets. This may not seem to pose a conflict, after all wages obviously belong to the worker, but it is because those wages must change character from being general assets of the employer, to wages of the worker, to pension plan assets, that creates the arena for conflict. The employer, who is charged with withholding the contributions from the worker's compensation, is also the party charged with depositing it into the appropriate investment account.[26] Employers delay depositing these contributions because they need to cover cash flow problems, thinking they will contribute them just as soon as the cash flow difficulty is remedied, or the employer uses the "float" time to generate interest or earnings on the monies for his own account. The assets cannot grow unless they are invested, and become increasingly at risk of never being deposited as more time passes. Every pension system is vulnerable to this conflict of interest if the employer is responsible for remitting contributions.

The failure to remit the withheld contributions from wages is likely the most widespread issue of non-compliance and conflict of interest within the U.S. pension system. Failure to deposit the contributions in a timely manner affords the employer an interest free loan for cash flow

[26] Additional problems in the US system exist because the employer generally also acts as the trustee of the plan, which has even greater responsibilities than fiduciary. Under the common law, a trustee accepts primary responsibility for the managements and assets of the plan, and can be held personally liable for any harm caused by any person. The trustee is charged with all responsibilities from choosing the investments and managing the investment portfolios to making distributions and oversight of all service providers. The employer has almost complete control over these monies from the time they are withheld from wages until disbursement as a benefit, with little disclosure required to the participant. This creates numerous conflict of interest situations that are not present in the pension systems reviewed in this paper because the employer is not allowed to act as the trustee.

purposes, and little motivation to make these deposits sooner. The participant is put at risk because the monies are co-mingled with the business assets, and prevented from earning while not invested. Should the employer declare bankruptcy or otherwise become insolvent, these monies are not protected from the business creditors because they are not yet characterized as pension plan assets. Further, in a volatile capital market, the participant is prevented from gains that could be earned if the monies were properly and timely invested. This is also one of the primary reasons the public's confidence in the pension system is undermined. Most countries examined here have this risk inherent in their system.

A significant problem in the US system is the failure to identify these monies as plan assets early enough in the pension cycle to protect them from inclusion in the employer's general assets.[27] Plan assets are most at risk during the transition from being wages to deposit into the investment or pension account. First, the character of these monies is in dispute, so there may no be consensus as to what agency has supervisory authority over this transaction, if any. Regulators must decide at what point these monies are wages, corporate, or pension assets. Second, many governments have not realized this could be a problem. In societies who culture is one of transparency and fair dealing in business, it may be unimaginable that employers would deliberately delay these deposits. Finally, it is difficult to regulate a timeliness standard with specificity because an acceptable deadline for one business entity may be unacceptable for another. For example, a corporation with several different payrolls may need weeks to segregate the pension assets from the wages and allocate them to the proper participant's account, whereas a very small employer could perform this function within a few days. Notwithstanding the complexity, this aspect of pension plan administration will pose one of the greatest challenges to the growth and integrity of the pension system, and should be a focus for each regulatory agency. If countries can adopt a bright line test for when this transition occurs, it would afford participants greater protection from the most prevalent conflict of interest.

A similar situation occurs when the contributions are deposited with the pension company or custodian, but actual investment of the monies is delayed. Pension plan custodians often maintain cash transfer accounts that hold funds waiting to be invested, reinvested, or paid out for benefit distributions, and then retain any interest or earnings on these monies resulting from short-term gains. This is called the "float," and is a self-dealing transaction. Without proper supervision, this delay could be excessive, unnecessary, and without benefit to the plan participants. Albeit, in a stagnant market the earnings lost or gained from this delay may be de minimis, but a volatile market could prove much different with greater potential for lost earnings, and greater motivation for custodians to delay making trades. In addition, while this money is "parked" in the cash transfer accounts, it represents an unsecured loan to the entity gaining the float interest.

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[27] US law does not give supervisors jurisdiction over these monies until they are determined to be plan assets. Regulations state they are plan assets "as of the earliest date on which such contributions can reasonably be segregated from the employer's general assets." 29 CFR section 2510.3-102. The appellate courts of the US are divided somewhat as to the benchmark for when this transition occurs, but typically review a sampling of actual remittances to determine an average, or use the time limits allowed for remitting federal wage taxes and social security as the benchmark.

Even with concrete regulations addressing the timeliness of depositing contributions and conducting transactions, supervisors must be alert for violations and sanctions must be sufficient. The primary supervisor in this transaction is the worker/participant who will suffer the consequences of absent or delinquent deposits, yet the reality of the worker enforcing his or her rights under this scenario is not likely. In a slumping economy that is most likely to create cash flow problems for employers, a worker will hesitate bringing this matter to the employer's attention for fear of suffering employment related consequences. Sanctions for failure to make deposits in a timely manner must be punitive and exceed any "cost of doing business." If the penalties are similar to the cost of obtaining a loan or other line of credit, the employer may see the pension contributions as a readily accessible source of cash reserves with no fees or administrative obligations. In addition, the employer knows workers will be reluctant to bring this matter to light, subjecting the worker to coercion or undue influence from the employer. For these reasons, supervisory responsibility must rest with the government and not solely with the participant.

Government supervisors can detect these violations easily and objectively by examining documentation specific to these transactions. Most businesses keep payroll records that show payroll dates as well as any withholdings made from wages. Deposit records show the dates and amounts of contributions made to investment accounts or pension companies, who will also have records showing the dates monies were received and shares were purchased. By comparing these records to one another, a supervisor can determine when contributions were withheld from wages, how much time passed before the employer remitted the contributions for deposit, and how long before the investment company traded the shares. By examining a number of payroll cycles from this employer, or comparing the practice of one employer with other employers of similar size and complexity, supervisors can reasonably determine if the monies were handled in a timely and proper manner.

Each country examined had an employer contribution component to the pension system, with several countries mandating this, but the pension laws did not directly address this conflict of interest situation. Slovenia requires plans to disclose consequences for non-payment of contributions as part of the licensing process during plan inception. This provision encourages timely deposit of contributions provided certain conditions are met, such as the party being sanctioned must be a party to the pension plan contract, otherwise there may be no authority to levy the sanctions; the sanctions must be substantial, and go beyond a cost of doing business; and there must be further legal redress in the event the sanctioned party still fails to comply. In the Mexican system, CONSAR has authority and responsibility for reconciling contributions with payroll records, as well as deposits to the investment accounts. Further, the SSA is responsible for collecting contributions, so a neutral government agency would have immediate knowledge of deposits not being made in a timely manner. Under the Hungarian system, part of the inspection process examines contractual agreements from service providers regarding the timely deposit of contributions. Provided these contractual agreements can also be enforced through court action, they will go far in preventing tardy or delinquent contributions.

Without proper incentives or sanctions, employers lack the motivation to make these contributions in a timely manner, particularly when other interests distract them from this task, such a poor corporate performance. This problem is further compounded in Chile and Costa Rica by the fact that each worker may choose to participate with a different AFP or plan administrator, creating an administrative burden and expense for each employer. In Costa Rica, SICERE collects contributions and remits them to the appropriate *operadora* on behalf of each worker, reducing the administrative burden on the employer somewhat. In other systems, the employer must ensure accuracy in depositing these monies not only to the proper account for each participant, but also to the proper plan administrator. Prudence would also require some confirmation that the deposit was received, thereby adding to the administrative responsibility. Employers would need experienced and trustworthy staff to handle these transactions, and would not receive any compensation for such; the employers' only incentive rests with taxation benefits, if any.

OECD guidelines on pension fund governance state that responsibilities should be clearly identified, including responsibility for collection of contributions. According to comments in this section, "[t]here should be a clear identification and assignment of operational and oversight responsibilities in the governance of a pension fund….The role of the plan sponsor and the rights of the plan/fund members with respect to the governance of the fund should be clearly documented." It further states that pension fund members should have access to "statutory redress channels" to recover any losses due to improper governance.

3.2 Self-Dealing Transactions by Plan Officials

Self-dealing transactions occur when a party makes decisions that cause unjust enrichment directly or indirectly. Generally, these situations involve a person with more than one duty of loyalty, most often with self-enrichment as the second dividing loyalty, using plan assets in their own interest. A direct transaction occurs when the fiduciary makes a decision that benefits his or herself without any other parties involved. An indirect situation exists when one or more intermediaries are used to conceal the chain of events that lead to the party's self-enrichment. Parties involved in plan administration or management, hereafter referred to as plan officials, may face a conflict of interest when they also serve as officers or directors of the plan's employer or of the entity in which assets are being invested.

Parties who provide services to a plan, such as investment managers, actuaries, or accountants, can also engage in self-dealing, conflict of interest transactions. Consider the following situations where a fiduciary is serving dual loyalties: self-interest and the plan.

- Plan officials who adopt an amendment that makes it difficult to remove them from office without seeking advice of counsel before adopting a new amendment.
- An investment manager investing plan assets in companies that it owns.
- The investment of plan assets in deposits in a bank who also acts as custodian of the plan assets.
- A plan official making loans to herself or her corporation.
- An insurance agent who encourages plan officials to repeatedly invest plan assets in products for which the agent receives undisclosed commissions, or products for which he receives larger commissions, rather than products best suited to the plan.

- Expenses for advertising open funds being passed on to plan participants.

In each of these situations, the conflict arises when a plan official makes a decision or takes an action involving plan assets in a manner that directly or indirectly benefits himself, and not because it was prudent for the plan. This causes the plan to miss the opportunity to increase its return, and subjects it to additional risk resulting in potentially devastating losses.

3.3 Conflicts of Interest with Service Providers

Aside from self-dealing transactions with their obvious conflicts of interest, conflicts also occur when a plan official serves the interest of a third party rather than loyalty to plan duties. Some sociologists claim there are no altruistic actions, causing the distinction between a self-dealing transaction and a third party conflict to blur. For example, if a plan official retains his brother as an auditor for a pension plan he administers, the plan official did not receive a personal benefit, but the enrichment of his brother's financial position may improve the overall family relationship, ultimately benefiting the plan official.[28] Nonetheless, we make a distinction here because most pension governance systems agree that self-dealing transactions are improper, whereas prohibition of this second type of conflict of interest situation varies from one country to the next. A common area for conflict occurs in the procurement or hiring of service providers to a pension plan. The number of pension plans is finite, creating competitive circumstances for service providers seeking contracts or agreements in this area. Often, there are a limited number of service providers qualified to provide specialized pension plan services, further enhancing the opportunity for a conflict of interest.

In the Hungarian pension system, custodians monitor the other service providers and keep current records of investment activities. They must warn the board if execution of a specific transaction could jeopardize the plan's interests, and can refuse to carry out an adverse transaction. This places the custodians in a position to refuse orders given by the entity responsible for their employment. The custodian may be selected improperly if the Board determines they will be malleable, or the custodian may be reluctant to defy improper instructions. Either situation results from a conflict of interest involving a service provider to the plan.

In the Latin American countries, plan participants can often choose the insurance company that will provide the annuity. If the administrator were receiving some benefit for steering business to a specific insurance annuity provider, the administrator might use undue influence on the participants to encourage them to select preferred providers.

The number of potential conflicts with service providers is enormous. Following are some specific examples of common conflicts of interest with service providers.

3.3.1 Portability

[28] See Diagram 3 showing a conflict of interest involving a service provider.

Distribution timing has more effect than just delaying the onset of retirement benefits. This aspect of plan administration can be used to manipulate required reserves, and to offset cash flow problems being experienced by pension companies.[29] It is difficult to maintain strict time limits on effecting distributions as the circumstances vary from one plan to another, as well as between pension companies. In addition, locating participants may be difficult, purchasing required annuities takes time, and other administrative setbacks cause delays. Nonetheless, any conflicts that could arise from this can be limited by instituting specific limits on the length of time a company has to rollover accounts or initiate annuity payments.

The movement of plan members between funds and administrators increases opportunities for this type of conflict of interest. Most countries allow some portability between plan administrators, pension companies, or pension funds, but regulators must also recognize that participants' assets and potential earnings are at risk during this transfer, particularly if time restraints are not legislated or regulated by law. From the time a participant's account is formally "closed" for valuation, transferred to the next fund, and deposited, the underlying investments continue to fluctuate in value. If the account is liquidated to cash and held in an interest-bearing account, there will be earnings on those monies, but it may not be clear who owns those short-term gains. If the time taken to facilitate the transfer is minimal, the gains, losses and interest are likely *de minimis*, and revert to the plan.[30] However, if the time required to complete a transfer is excessive, the costs can be significant, resulting in unjust enrichment to one of the parties involved. Some fund administrators could deliberately delay this process, particularly in a volatile market. In addition to gaining the interest, or float, they could essentially hedge investments waiting for the most opportune time to sell. Plan administrators could manipulate reserve requirements through the same manner, possibly manipulating balance sheets to reflect inaccurate asset values and misstate actuarial requirements.

Proactively, time limits can be regulated for paying retirement benefits or transferring plan assets from one fund to another, and reflective of the country's specific pension administrative structure. If exact deadlines exist, supervisors can readily determine whether the regulatory time limits are met. If specific time limits are not stated, supervisors must use discretion in determining whether the plan administrator has been prudent, first by computing the average benefit request to payment turnaround. By comparing the average turnaround time to a sampling of actual benefit payments made, the supervisor can determine whether certain benefit payments exceed a reasonable processing time. This would provide a good indicator that the plan may also be experiencing other cash flow problems, suggesting further inspection is warranted. Under Slovenian pension law, plan contracts provide specific time limits for distributions from plan accounts. In the case of "extraordinary termination" of plan participation, such as death of the participant, distributions must be made in cash lump-sum payment within 60 days of the

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[29] See Diagram 4 regarding distribution timing conflicts of interest.
[30] This is an example of a conflict between a participant and the plan. If the plan administrator pays these short-term gains to the participant, the plan loses potential earnings. If she keeps them for the plan, the participant has forfeited gains. If the plan administrator keeps them for personal use, a self-dealing transaction has occurred.

termination. Transfers of plan assets from one plan to another must be completed within 30 days of the transfer request.[31]

3.3.2 Account churning

Account churning is a self-dealing transaction where an investment manager or advisor receives commissions when securities are bought or sold. The manager orders an excessive number of transactions with pension plan investments, generating commissions for herself. Every pension system that allows securities as an investment for plan assets is vulnerable to this conflict of interest if the person executing the trades is also the person who decides what investments to make. Account churning is a difficult conflict of interest to regulate proactively because assigning a quantitative limit on transactions may not always be in the best interest of the plan. The countries examined did not have specific prohibitions in the pension laws preventing this, although most countries would consider it a conflict of interest under more generalized prohibitions. In addition, many countries have securities markets with limited offerings, so churning would be obvious and not problematic yet. However, as the pension systems grow and plans diversify portfolios, supervisors must consider this possibility and review transaction summaries for evidence of excessive trading. This is particularly true when the investment manager is paid a commission on each trade, rather than a flat fee or on a percentage of assets managed. In the US system, churning is directly prohibited by the Securities and Exchange Commission, but not by ERISA, the US pension law.

In Chile, a similar situation can present with churning administrative fees charged by the AFPs. AFPs charge fees for depositing the participants' regular contributions, for transfer of any participants' assets to another AFP, on payments of temporary income, and for processing scheduled withdrawals. These fees are based on a percentage of the contribution, as a flat rate, or as a combination of both methods, and typically do not exceed two to three percent of the participant's wages. Nonetheless, AFPs can use these withdrawal fees as leverage to keep participants with a plan administrator longer than the participant prefers, or making transfers between AFPs lengthy and difficult.

Along with account churning, supervisors should be aware of other conflict of interest transactions involving asset management including:

- Soft dollars charged to plans as commissions paid to brokers for executing a trade, as well as a commission paid to an investment manager for the same transaction.
- Hidden and/or excessive fees charged for executing transactions or investment management services
- Duplication of fees where more than one service provider performs the same service.

[31] According to Article 320(4) of the Pension and Disability Act, a pension scheme must give time limits for disbursements of purchase value.

3.3.3 Kickbacks

Kickbacks occur when a plan official receives something for facilitating a transaction involving plan assets, such as receipt of some form of commission or payment for causing or influencing the plan to engage in a certain transaction. For example, if a plan official directed the plan to invest in a company that paid the official a commission or finder's fee, it would be a kickback. Another example is a pension plan official receiving free services or products from a service provider. In Slovenia, an employer must contract with an operating company to administer a plan he sponsors, and most operating companies are banks or insurance companies. The employer may choose an insurance company as the operating company for his pension plan that he also uses for business insurance. If this company offered the employer a reduction on his business insurance for selecting this as the operating company, it would be a kickback. Because of structural and regulatory difference, this is less likely to happen in either Poland or Hungary.

3.4 Conflicts Related to Minimum Guaranteed Rates of Return

A minimum guaranteed return on pension investments assures participants of some growth over time, and may relieve the government of future subsidy obligations by sharing the responsibility and risk with the plan administrators. However, it also creates a climate for conflicts of interest and improper corporate governance, as does the requirement for minimum cash reserves, depending on the structure of the pension system, the responsible party for offsetting deficiencies, and the sanctions for failing to meet the minimum rate. The question must be whether the protection afforded outweighs the potential for other problems.

For example, in Slovenia, pension law requires a minimum guaranteed rate of return. If this rate is not met, the plan administrator must pay any deficit remaining after the fluctuation reserve is exhausted, yet the fluctuation reserve cannot exceed ten percent of the pension fund assets. The plan administrator is also responsible for the quarterly reporting of the fund's return on investment. The law was designed to align the plan administrator's interests with the plan participants', but the sanctions are not aligned, creating a conflict of interest. The participants' bear no actual risk to the plan under performing because their return is guaranteed, but the administrator's operating assets are at stake. Further, the responsibility for reporting this failure to achieve the minimum return is in the control of the one who will suffer the consequences creating a climate ripe for misreporting. If the minimum is not achieved over time, the plan is terminated.

The Chilean system differs slightly from this in that the AFP must maintain a one percent reserve payable from its own assets, and the minimum rate of return only applies to certain plan participants. Further, if the minimum return is not achieved, the government subsidizes the deficiency rather than the AFP. Rather than having to fund the deficit, the AFP is liable for fines or other sanctions from the SAFP instead. Although this still adversely affects the AFP, the sanctions are less immediate and likely less costly than in the Slovenian system. Because of this, there is less incentive to misreport earnings, particularly if the penalties for misreporting far exceed any penalties for failure to earn the minimum return.

Within the Hungarian pension system, guaranteed rates of return are paid through a fluctuation reserve that is funded by participant contributions. If the reserve is depleted, participant contributions and excessive earnings are used to offset any deficit on the minimum rate of return. Because these plans are owned and operated by participants, fluctuation reserves come from contributions and excessive investment earnings. Reserves are adjusted actuarially if upon retirement a participant receives her annuity from the plan rather than purchased from an insurance company, and the plan administrator, who is typically the Managing Director hired by the Board of Directors, decides who will pay the annuity. Although the plan administrator still does the reporting, unless the administrator is also a plan participant, there is no conflict of interest creating a climate for misreporting.

Supervision for this situation is best accomplished proactively by separating the responsibility and functions of the plan administrator, or by requiring an independent accounting of the rate of return, rather than retroactively. If the party responsible for funding a deficit is also the party responsible for reporting it, the conflict of interest is inherent. However, by requiring a third party to perform the accounting and reporting function, the conflict is somewhat abated provided the third party is truly independent. In addition, frequent reporting of the return on investment lessens the ability to manipulate the records that evidence the shortfall. Many countries require daily valuations of investments leaving the balance of the reserve account as the primary target for misreporting. Even though the total value of the pension accounts affects the amount of reserve required, daily reporting lessens the ability to manipulate this figure. Using daily valuations as the basis for reserve requirements, supervisors are able to determine retroactively whether misreporting has occurred. Reserve requirements are determined through the daily valuations, and to determine whether the minimum rate of return has been achieved. If less frequent valuations are used, or plans invest in securities whose value is not readily available, supervisors must conduct extensive inspection with forensic accounting techniques to find misreporting.

3.5 Transactions with Relatives or Friends

In some countries or cultures, conducting transactions with relatives is not only acceptable, but also preferred. These transactions may be perfectly reasonable in fact, but often create the appearance of a conflict of interest, potentially undermining the confidence the public has in the system. The appearance of a conflict can also be the gateway to an actual conflict. As the familial relationship between the parties tightens, so does the potential for actual conflict. Avoiding an actual conflict becomes far more difficult when conducting business with a close relative. Fortunately, transactions with relatives are easy to regulate because definitive lines can be drawn by each government as to the degree of acceptability and closeness of the family tie to the transaction. For example, in the United States, transactions with spouses, parents, or children are not allowed, but transactions with siblings are.[32]

Looking closer, though one finds a similar situation exists in countries with centralized financial and geographic markets where many of the pension actors live and work in close

[32] See ERISA section 3(14).

proximity. Often smaller countries have only one university that most citizens attend for their professional training; close friendships develop there and continue throughout the careers of these individuals. These bonds can be just as close, if not closer, than familial relationships. These friendships can also create conflict of interest situations, but unlike familiar relationships, are much more difficult to detect and prevent because of the lack of objective standards of measurement. An examination of the ownership records of all entities providing services to the plan and all parties working for such entities in a decision-making capacity, may uncover parties with similar surnames. Interviewing the plan officials regarding the selection process and criteria for plan service providers may unveil favoritism based on previous or personal relationships. A further review of all expenses paid on behalf of the plan and to who paid, might offer similar information.

3.6 Loans Between Plans

Finally, lending of plan assets often creates conflicts of interest, particularly if the loan is from one pension plan to another. Although this situation does not often occur, it can when pension companies administer more than one plan. One instance may occur if one plan is under funded actuarially, while another is over funded. This can happen when an employer fails to transmit contributions to the investment company, when actuarial assumptions change, or because of a drastic change in the age distribution in a plan. To compensate for a short-term funding deficiency or cash flow problem, a plan may need to borrow funds from another source. Some administrators may see another plan that is over-funded as a convenient source. However, if plan officials negotiate a loan between the plans, there is a direct conflict of interest even though the plan official may not benefit directly. This would most likely be seen under the Chilean system, where AFPs manage more than one plan at a time.

A plan official charged with administration and management of the plan must act in the best interests of that plan. On one hand, if a plan he administers needs a loan, he has an obligation to negotiate the lowest interest rate possible along with the most favorable terms. If a plan has money to loan, this official must invest it to get the highest rate of return possible. If this same official is working on both sides of this transaction, it is almost impossible for him to work in the best interest of each plan and its investment policies.

4 Examples of Unique Conflicts of Interest in Select Countries

4.1 Chile and Costa Rica

The Chilean pension system contains unique features that protect it inherently from many conflicts of interest while exposing it in other areas. In addition, some regulatory features facially appear to protect plan participants and their pension investments may inadvertently create the very need to engage in a conflict of interest. The Costa Rican system has many similarities to the Chilean in regard to protection from and vulnerability to conflicts of interest. For example, AFPs can collect fees for certain functions, and must maintain a minimum cash reserve totaling one percent of all the plan assets managed. Further, these reserves are maintained to offset insufficient earnings on investments. If the AFP is experiencing significant financial difficulties to the extent that liquidity is an issue, there is a strong likelihood the investments have not been performing as required. The reserves would be needed to offset poor performance, but also to pay creditors prior to the liquidation. Solvency laws must address the preferential treatment of participants over creditors, as well as determine the character of these monies at various stages in the liquidation process.

Although Chilean law allows any group of shareholders to own an AFP, attention must be paid to whether these shareholders also maintain other lines of business that provide services to the AFP, such as insurance products. These pension management companies can also provide consulting services to foreign pension plans, while being allowed to invest up to 30 percent of plan assets in foreign securities. Depending on the structure of the foreign plan, be it open or closed, the AFP could be providing services to a pension plan sponsored by a company in whom it also has acquired securities. Because of the diversification restrictions, it is not likely that the AFP could exert much control or influence over the underlying corporation, but the potential for a conflict does exist.

AFPs can provide services to the Chilean public pension system, opening the possibility of kickbacks, and creating a situation whereby the government could ask the AFP to exert some other force, for instance on a foreign pension system, as a condition of retaining the government's account. The government is also the insurer of last resort to the private pension system, probably with monies invested at the direction of the AFPs. If the AFP has not produced a sufficient return to meet the ten percent minimum guarantee, thereby causing the government to subsidize, the chances are that the government has also experienced insufficient returns on the monies it invested at the advice of that particular AFP. Thus, poor performance by the AFP for the private system likely equals poor performance for the government account, exposing those participants to a double loss if the government is unable to marshal assets from its other investments.

A significant potential for conflict of interest rests with the prohibition on AFPs from investing in the same securities that it has any pension assets invested in. Assuming the AFP meets the directive to manage the pension assets in the best interest of the participants, it will choose the best securities for investment with plan assets. Therefore, the only investments left for the AFP to invest in are less attractive and possibly poorer performers. Assuming human nature to be what it is, AFPs are at least somewhat likely to put their own assets in superior performing securities, thereby forcing some plan investments into the less attractive stocks. It might be more advantageous to allow both entities to invest in the same securities, but place restrictions on percentage of ownership, exertion of control over the underlying corporation, and voting restrictions. By allowing both entities to invest in the crème de la crème, there is a mutuality rather than conflict of interest.

Similarly, in Costa Rica, operadoras purchase and manage a portfolio of securities, then enter into a contractual agreement with participants who purchase an interest in a portion of the portfolio. Operadoras do not know who will be participating in each plan at the time they purchase the securities; so preventing conflicts of interest is more difficult. Further, the treatment of gains or losses in the interim between purchase by the operadora and sale to the participants of a plan is unclear.

4.2 Hungary, Poland and Slovenia

The Hungarian law is one of the few with specific prohibitions against conflicts of interest. Primarily these are focused on service providers to the plan, and to the composition of the Boards and employees of the plan. As do many of the pension systems, the Hungarian system requires significant disclosure during the plan licensing process, perhaps in an effort to thwart certain conflicts of interest before they arise. Unlike the Chilean and Costa Rican systems, pension plans operate as mutual savings associations, vesting ownership of the plan in the participants. This creates a melding of interests for the plan and participants, whereby making a fair and reasonable decision for one almost automatically benefits the other. However, this structure is not without potential problems. A plan cannot operate with all participants making decisions on every action, so a General Assembly is elected who then selects the Directors and Supervisors. Although not frequent, the possibility of a Director making a self-serving decision or transaction that benefits him or her more substantially than the other plan participants does exist.[33] An example is the overpayment of benefits upon distribution to a Director where he or she has authority to amend the plan to allow for this, and then re-amend the plan back at a later date. This decision may be well within the Director's authority, and for all practical purposes benefits a participant, but overall harms the plan.

Under the Polish system, pension societies are considered non-profit corporations, provided administrative fees collected from members are less than .06 percent of the plan's assets per year. The employer plan sponsor would pay any fees exceeding this amount. Without proper controls in place, the employer has incentive to find the least expensive service providers, provide the least amount of services, and to attract kickbacks to offset his or her cost. The employer will also attempt to keep all fees down so the .06 percent threshold is never exceeded, or exceeded only minimally. This can be prevented through the equal representation of employers and workers in the pension society administration, but it the equal representation can also enable deadlock.

Finally, Slovenian law requires trade unions to be involved at the plan design stage, and act as a representative of the workers to ensure fairness in this document. However, trade unions could use this authority as a bargaining leverage when negotiating for other aspects of workers' rights.

4.3 Mexico

The Mexican government has retained significant authority and control for pension supervision in the agency, CONSAR. Rather than sharing authority between several agencies, CONSAR has authority to oversee almost every aspect of pension plan administration, including service providers, with authority to sanction without much warning. This creates a much more efficient method of pension supervision, provided there are no conflicts of interest between CONSAR and any of the pension plans or service providers.

[33] More often it is seen that a decision must be made that benefits the plan even if an individual participant is harmed, but the reverse of this can also occur.

Contributions to the pension system are collected by the Central Bank. Until recently, this organization was not heavily regulated for conflicts of interest. However, recent legislation is designed to reduce this possibility. The capital market regulations are not likely to impact the pension plans much at this time, as they too are underdeveloped, particularly in the area of conflicts of interest. These markets are less developed, with few securities being offered, and little regulation. For now, the limited number of entities to invest in and supervise makes governance much easier than it will be later when more entities and instruments are offered. Typically, the banking industry has provided much of the financial services to corporations. Pension plans could offer an alternative for companies to acquire capital. Therefore, the banks and the pension plans may be in direct competition for this market as the pension plans grow. Regulators must watch for conflicts that may arise if banks are also involved in plan management of administration. Banks could use their involvement with pension plans to direct monies back to their own accounts.

5 Conclusion

Basic tenets of loyalty preclude a plan official from engaging in transactions that are self-benefiting, or with third parties to which he or she owes a duty of loyalty. To do otherwise creates a conflict of interest situation that undermines the entire private pension system. Therefore, these conflicts must be regulated, discovered, remedied, and prevented whenever possible. The responsibility for this rests with many entities, not just the government. Many countries already have regulations in place, or ready to be adopted, which address conflict of interest situations and prohibit certain transactions. However, no system is completely secure against these situations, so appropriate remedies and sanctions must exist to allow redress for the affected parties.

At the heart of this lies the truth that every transaction with an employee benefit plan provides some degree of conflicting interest. Identifying these situations and creating a regulatory scheme that allows only beneficial transactions while punishing those deemed abusive is the first step in ensuring a safe environment in which to invest for retirement. By examining some prohibited transactions, supervisors develop a sense of where to look for conflicts of interest that cause harm to pension plans. There are as many situations and transactions giving rise to a conflict of interest as there are people to imagine them. Sharing information will alert pension supervisors to the warning signs of potential problems, reduce the detrimental effects on plans, and build public trust in the private pension system. Citizens must have confidence in the pension system's security and fairness. To this end, governments must provide safeguards in the form of laws, regulations, and supervisory efforts to ensure monies invested for long-term retirement needs are safe and wisely invested to maximize the return.

Diagram 1 – Retirement Investment Cycle

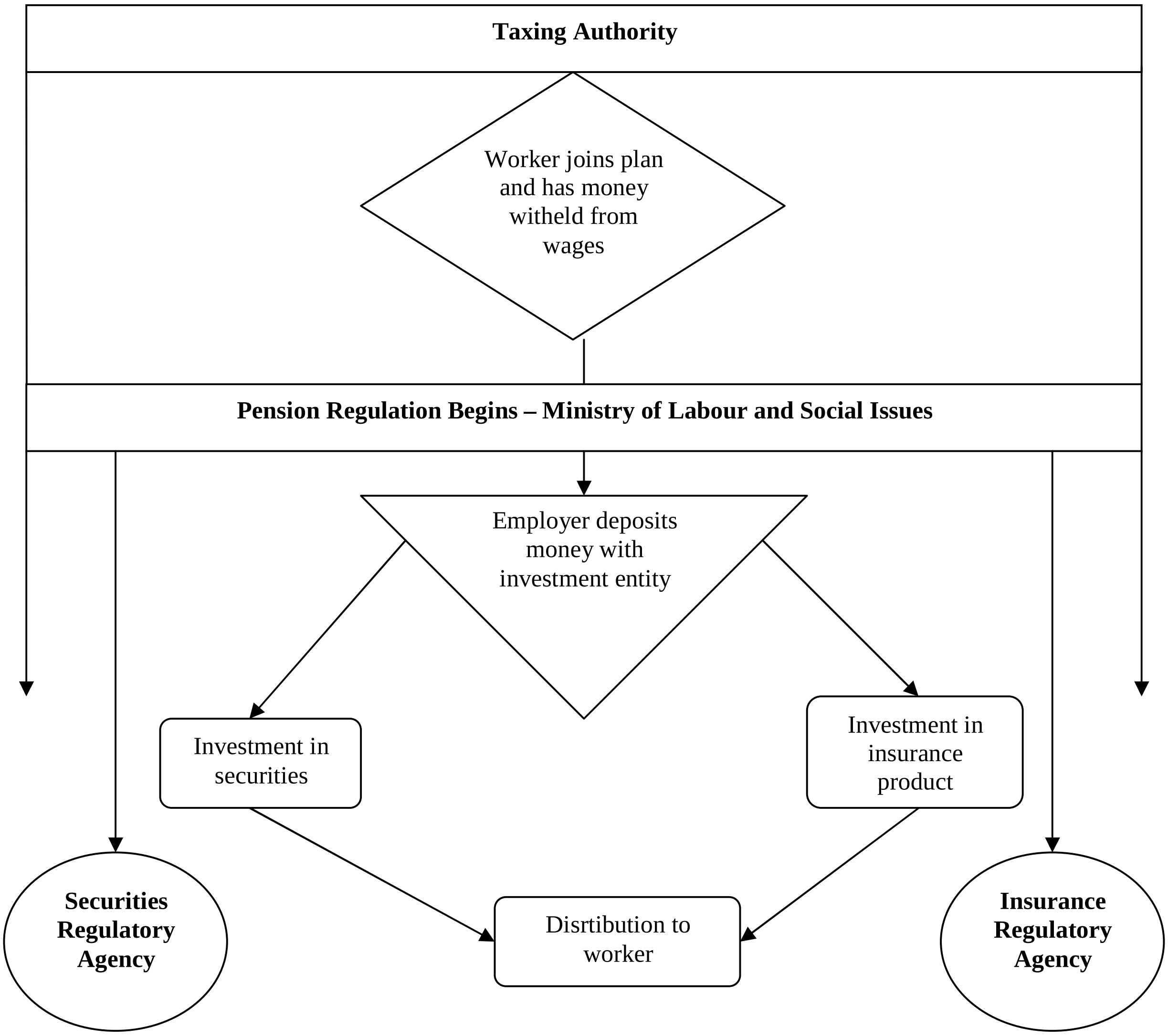

Diagram 2 – Hungarian Mutual Saving Association

Board of Directors
Hires Managing Director
Hires Expert Committee members
Determines business policies
Maintains accurate records

Managing Director
Implements Board Resolutions
Must operate Plan
profitably

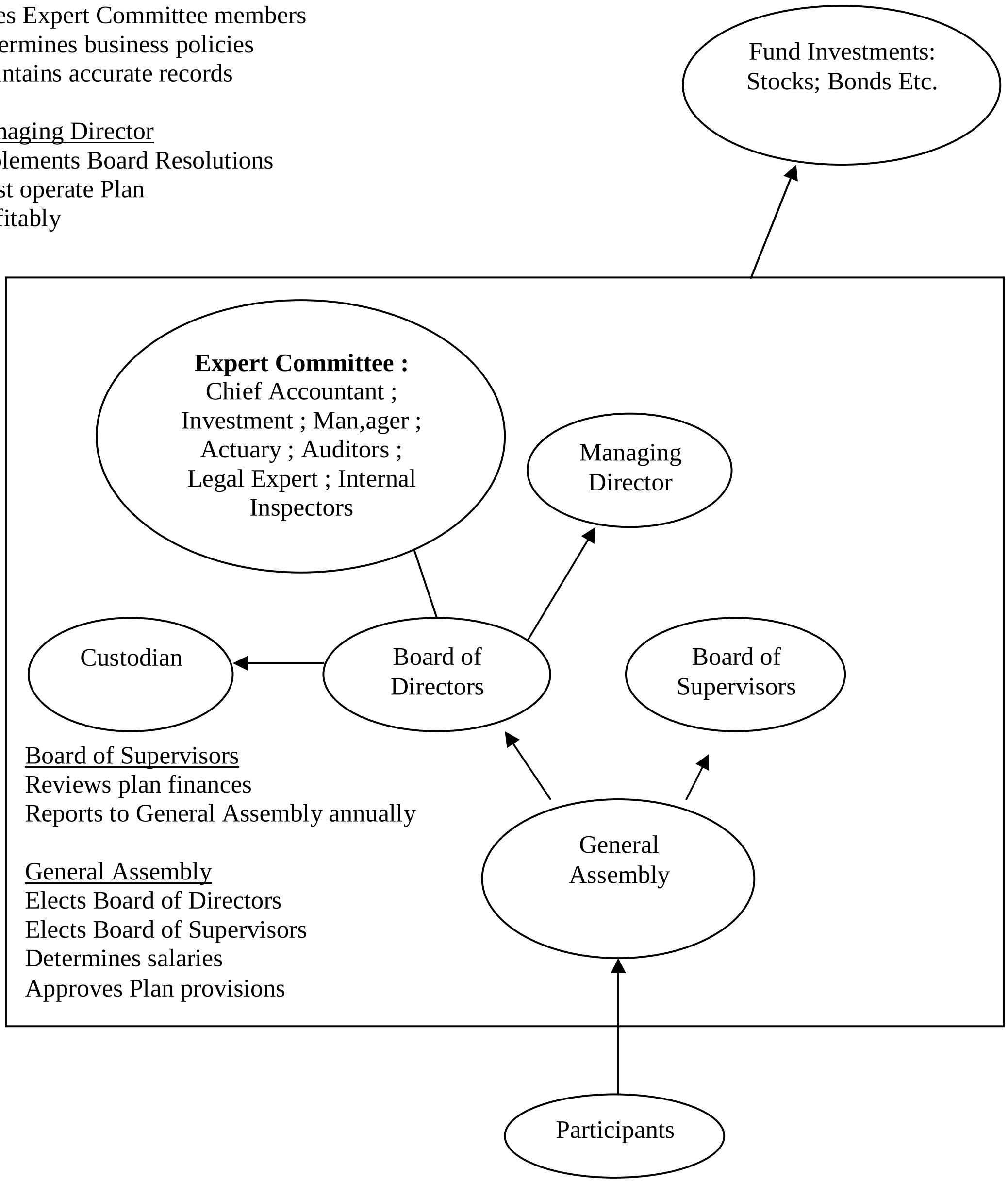

Diagram 3 – Overview of Present Systems

	CHILE	COSTA RICA	HUNGARY	MEXICO	POLAND	SLOVENIA
Plan Administration	AFP (private administrators)	Operadoras (private administrators)	Self-administered	AFORE (private administrators)	Pension societies, management companies or insurance company	Mutual pension company or operating company
Structure	Joint Stock Company	Corporations	Mutual savings associations	Single purpose corporation	Corporation, profit or non-profit	Joint stock company
Ownership	Any group, as shareholders	Participants	Participants	Private stockholders own AFORE; participants own SIEFORE	Participants or shareholders	Participants
Governance	Government does primary oversight	Government does primary oversight	General assembly oversees Board of Directors and Board of Supervisors	Board of Directors oversees AFORE	Pension society or management company, depending on type of plan	Supervisory Board oversees management board
Asset Management	Pension funds	Operadoras	Managing Director and outside asset managers	AFORE	Plan administrator	Management and supervisory boards
Service Providers	Actuaries, auditors	Insurance companies, auditors, accountants	Insurance companies, accountants, auditors, asset managers,	Banks, insurance companies	Outside administrators	Actuaries, accountants

			custodians			
Conflicts Prevention	AFPs cannot invest in same entities as plans		Pension law prohibits parties with conflicts from holding plan positions	AFORE must invest in same funds as plans it manages		Regulations encourage self-reporting
Investment Diverification Rules		XX	XX	XX		
Prohibited						
Transactions	XX		XX	XX		
Audits			XX			XX
Other			Custodians monitor other service providers; notify Board of potential conflicts			

Glossary

Benefit – Money paid to a participant or beneficiary upon retirement or other qualifying event, causing a distribution from an individual's account balance and withdrawal from the plan

Beneficiary – A person designated by a participant, or by the terms of the plan, who is or may become entitled to a benefit under the plan, i.e. a spouse who may inherit a benefit upon death of the participant.

Conflict of Interest – A situation wherein a person or entity has divided loyalties between two separate interests or obligations, most often a monetary self-interest and a professional duty of loyalty. Typically, the conflicted party serves one interest to the detriment of the other.

Contribution – Money or property given to a pension plan from a source outside the plan that increases the overall value of the plan. Typically, it does not include gains, interest, or dividends earned on existing plan assets, as these are referred to as earnings.

Custodians – The person or entity who retains physical control of the plan assets—cash or tangible property, or the indicia of ownership, such as the bank accounts, stock certificates, leases, promissory notes, deeds, or other documents granting ownership.

Distributions – The payment of pension benefits from the plan, whether upon reaching retirement age or because some other condition allowing exit from the plan has been met, such as moving to a different plan.

ERISA – The Employee Retirement Income Security Act of 1974, which establishes minimum standards of fiduciary conduct for persons or entities dealing with pension plans, provides for enforcement through civil and criminal sanctions, requires adequate public disclosure of the plans' administrative and financial affairs, and improves the equitable character and soundness of private pension plans by requires vesting accrued benefits, meeting minimum funding standards, and guaranteeing the adequacy of the plan's assets against risk.

Fiduciary – Any person or entity that exercises any discretionary authority or control with respect to management of a pension plan; with respect to the management or disposition of any of its assets; and/or in the administration of the plan. This also includes any person or entity that renders investment advice as to the plan's assets for a fee or other direct or indirect compensation or has any authority or responsibility to do so. A fiduciary owes a complete duty of loyalty to the person or entity to which he serves in this capacity.

Fluctuation reserve - Funds set aside to cover changes caused by fluctuations in the market value of the pension plan investments.

Investment Manager – Any person or entity that has the power to manage, acquire, or dispose of any asset of a plan. This party is usually considered a plan fiduciary.

Joint stock company - An unincorporated business enterprise with ownership interests represented by shares of stock.

Open pension plan – A plan that does not restrict eligibility to participate to workers of a specific employer, union, or trade.

Operating company – See "pension company."

Participant – Any person who is or may become eligible to receive a benefit of any type from the pension plan, or whose beneficiaries may be eligible to receive such a benefit.

Pension companies – Entities formed for the sole purpose of administering and managing pension plans. These companies may administer one or more plans, depending on individual governmental restrictions. They can be privately owned corporations, or operate as a mutual company wherein the pension plan participants also own shares in the company.

Pension Fund – A mutual fund created specifically for the investment of pension assets. Entities who manage these funds are known as *pension fund managers.*

Pension Plan – Any plan, fund, scheme, program, or arrangement established or maintained to provide retirement income to its participants.

Plan Administrator – A person or entity with responsibility for ensuring that all requisite filings with the government are made in a timely manner, and the person charged with making important disclosure to participants about plan benefits. The plan administrator's duties will depend on the terms of the plan's governing documents or delegation of fiduciary duties by a plan fiduciary. Such other duties may include hiring service providers, determining eligibility to participate in the plan, making benefit determinations, and maintaining plan records.

Plan Assets –Monies held by a plan for the benefit of participants and beneficiaries, used to pay retirement benefits, or to invest with to increase available retirement benefits. This includes, but is not limited to, real and personal property of all kinds, securities, debt instruments, leases, loans, and mortgages, cash and cash equivalents.

Plan Contract – Document that establishes the plan and defines the terms of its management and administration. Generally, this document defines who is eligible to participate, who makes contributions, and the criteria for eligibility for benefits and distributions. Also defines responsibility for each aspect of plan administration and asset management. It may also describe the investment strategy and funding mechanism for retirement benefits.

Plan Official – Any person performing management or administration of the plan or its assets. Typically the same as a fiduciary.

Plan Sponsor – The person or entity that establishes the plan, and determines how it will be managed and maintained. Generally, a plan sponsor is not a plan fiduciary unless it retains authority over some aspect of plan administration or management.

Relative - A spouse, ancestor, lineal descendant, spouse of a lineal descendant, sibling, spouse of a sibling, or lineal descendant of a sibling.

Service Provider – A service provider is a person or entity hired by a plan administrator to perform functions the administrator cannot, usually due to lack of expertise. Typically, this includes accountants, actuaries, attorneys, investment managers and financial advisors. Generally, service providers are not considered fiduciaries unless they exercise discretionary control or management over the plan or its assets.

Soft dollars – Payment of commissions to a broker instead of paying directly for services rendered to a plan.

Tax deduction – A reduction in one's gross income to determine the taxable income, thereby reducing the total amount of taxes owed. This can also be in the form of a tax credit, which is an amount used to directly offset any taxes owed.