

# Pension Governance

## Your Fiduciary Liability - What You Need to Know

**September 29<sup>th</sup> and 30<sup>th</sup>, 2004**

**Goodmans**



INTERNATIONALLY MILLIMAN GLOBAL

**Eckler Partners Ltd.**

*Consultants and Actuaries*

# Pension Governance

## The Legal Framework

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# What is Pension Governance?

Governance is:

- Overseeing...
- Managing...
- Administering...

...a pension plan to ensure compliance with regulatory and fiduciary obligations

# Why Is Pension Governance Important?

- Contributes to positive plan performance
- Helps avoid making errors
- Helps ensure a secure retirement for your employees
- Reduces potential liability
  - Provides a “due diligence” defence

# Overview

1. Who Is Responsible?
2. What Are The Obligations?
3. What Guidelines Are Available Regarding Governance?

# Who Is Responsible?

- The administrator
- One administrator responsible under statute
- May be same as plan sponsor or may not
- Where administrator is employer, generally board of directors is ultimately responsible
- Other parties may also have fiduciary obligations, e.g. actuaries, custodial trustees, investment managers, lawyers

# What are the Obligations?

- Ensure plan administered in accordance with laws and plan documents
  - where conflict, law prevails
- Adhere to standard of care

# Fiduciary Standard of Care

- Administrator must comply with standard of care set out in the relevant statute and in common law of trusts

# Statutory Standard of Care

- Exercise the care in administration and investment of the pension plan and fund that a person of ordinary prudence would exercise in dealing with the property of another person
- Use all relevant knowledge and skill that administrator possesses or by reason of administrator's profession, business or calling ought to possess

# Characteristics of Fiduciary Relationship at Common Law

- One person is vested with discretion or power
- That person can exert power to affect interest of another person
- Other person is vulnerable

# Standards for a Pension Plan Fiduciary at Common Law

- Honesty
- Prudence
- Not to delegate decision-making power unless to qualified person
- Must maintain an even hand between different classes of beneficiaries
- No conflict of interest/loyalty

# Sample Conflict of Interest Issues

- Pension administrator is often also the employer
- Administrator has fiduciary duty to members
- Company has shareholders to whom it must account
- Be aware of distinct roles
- Document decision-making process and get outside advice

# What Guidelines Have Been Released Regarding What Constitutes Good Governance?

- CAPSA Guidelines
- Guidelines for CAP
- OSFI Guidelines

# CAPSA Guidelines

1. Fiduciary responsibility:
  - administrator has fiduciary and other responsibilities to members and potentially to other stakeholders
2. Governance objectives:
  - establish governance objectives for the oversight, management and administration of plan
3. Roles and responsibilities:
  - describe and document roles, responsibilities and accountability of all participants
4. Performance measures:
  - establish performance measures
  - monitor performance of participants who have decision-making authority

# CAPSA Guidelines continued

5. Knowledge and skills:

- duty to apply knowledge and skills

6. Access to information:

- administrator and delegates should have access to relevant, timely and accurate information

7. Risk management:

- establish internal control framework which addresses plan's risks

8. Oversight and compliance:

- establish appropriate mechanisms to oversee and ensure compliance with law and plan documents

# CAPSA Guidelines continued

9. Transparency and accountability:
  - provide for communication of governance process to members and other stakeholders to facilitate transparency and accountability
10. Code of conduct and conflict of interest:
  - establish code of conduct and policy to address conflicts of interest
11. Governance review:
  - conduct regular review of plan governance

# Purpose of Guidelines for CAP

- Outline rights/responsibilities of CAP sponsors, service providers and members
- Ensure CAP members are provided information/assistance required to make investment decisions

# What if Pension Not Properly Administered?

- Contravention of a provision of the statute = offence
- Cannot establish a due diligence defence
- Potential personal liability
- Other potential actions: breach of trust/fiduciary duty, negligence

# Effective Pension Governance

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# Effective Pension Governance

- Consists of:
  - Complete documentation
  - Establishing a governance framework
    - pension committee, terms of reference, etc.
  - Developing policies
    - funding, education, investment etc.
  - Defining roles and responsibilities
    - who is looking at what and how often
  - Monitoring and ongoing auditing
    - investment, third party providers etc.
  - Managing Risks

# Documentation

- Includes:
  - SIP&P
  - Investment monitoring report
  - Plan document
  - Trust agreement
  - Actuarial report
  - Governance document
  - SPD, AIR, Form 7, Audited Statements

# SIP&P

- Sets out policies and objectives
- Links investment policy with investment monitoring
- Quantitative and qualitative evaluation
- SIP&P must be reviewed and confirmed or amended annually

# Investment Monitoring Report

- Is the investment manager performing to expectations?
- Compares performance, asset mix, risk, etc. to stated benchmarks:
  - absolute, peer group, passive
- Evaluates both quantitative and qualitative
- Reduces / avoids surprises
- Frequency of review
  - quarterly, semi-annual, annual

# Investment Monitoring Report

## Ongoing

- Issues are assessed immediately
- Qualitative changes at the investment management firm
  - Loss of key personnel
  - Change in ownership
  - Illegal activities

## Quarterly

- Overview of quantitative factors – look for warning flags
- Performance review, asset mix review

## Annual

- Detailed quantitative analysis:
  - style analysis
  - attribution analysis
- Detailed qualitative analysis
- Comprehensive summary

# Pension Plan Document

- Applicable to all retirement programs
- Official document, part of filing requirements
- Defines sponsor's obligations
- Should be clear and concise
- Should address:

- Purpose of plan
- Definitions e.g. Company, Earnings, Administrator
- Benefits on termination, death and retirement
- Payment of fees from the plan

- Information available to members
- Amendment, termination provisions
- Surplus ownership and contribution holidays

# Trust Agreement

- Applicable to all retirement programs
- Official document, part of filing requirements
- Should address:

- Authorized parties
- Payments from the trust
- Investment of the trust
- General powers and duties of trustee

- Reporting and recordkeeping
- Compensation and payment of fees for the trust
- Amendment, termination provisions

# Actuarial Report

- Applicable to defined benefit plans
- Part of initial and ongoing registration
- Multiple users of report
- At least every three years
- Purpose:

- Determine funded status
- Minimum and maximum contributions including going concern and solvency special payments

- Describe actuarial assumptions
- Reconciliation of data
- Confirm investment strategy versus liability makeup

# Governance Document

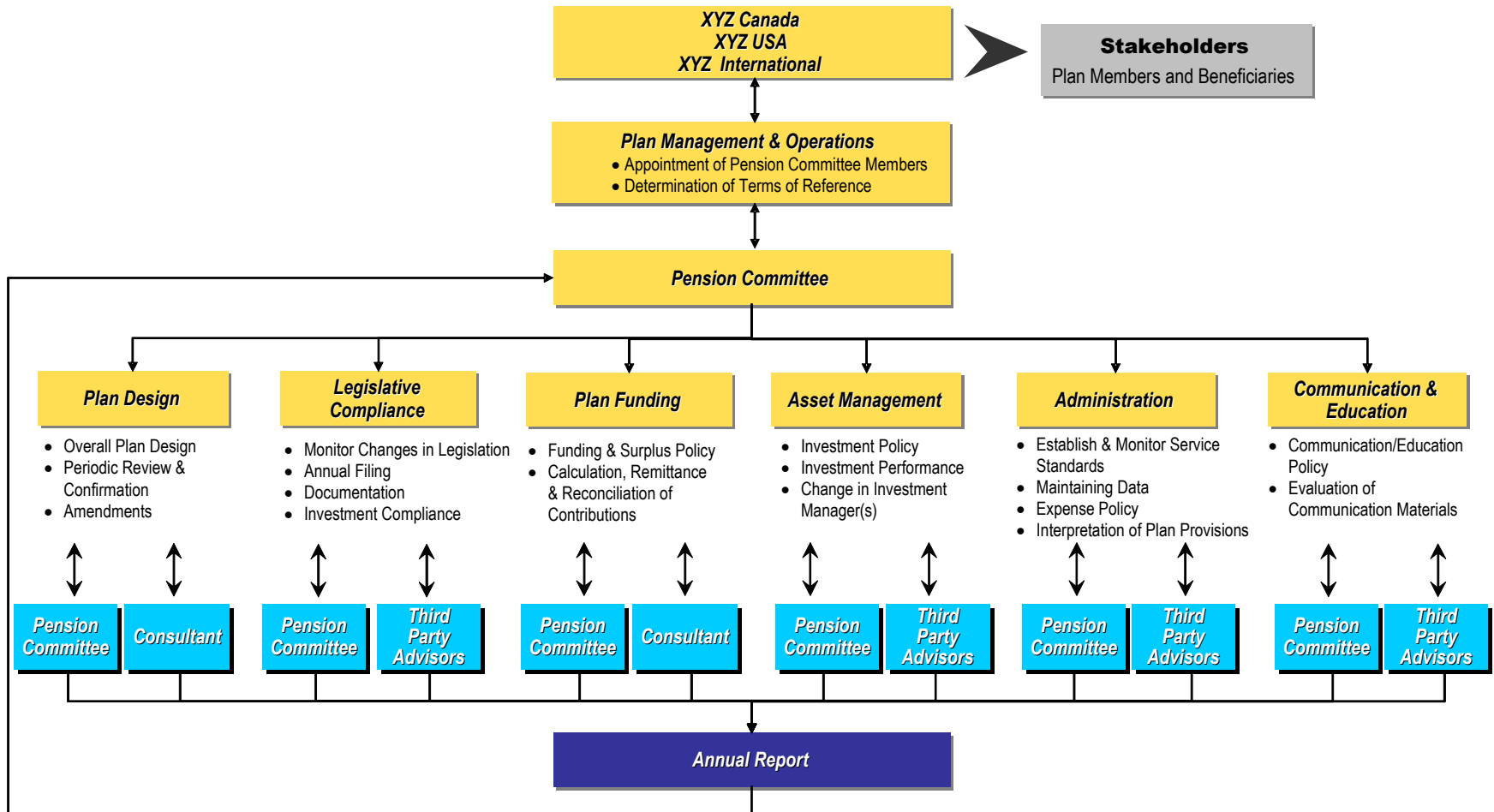
- Applicable to all retirement programs
- Not a required document
- Roadmap to CAPSA and CAP guidelines
- Purpose is to formally document duties/responsibilities
- Customized for each organization
- Typical document addresses:

- Plan's mission statement
- Governance structure
- Plan design
- Legislative compliance
- Plan funding
- Asset management
- Administration

- Education and communication
- Conflict of interest policy
- Committee's terms of reference
- Responsibility chart

# Governance Flowchart

## The Pension Plan for Canadian Employees of XYZ Company



# Operational Structure

- What form does your operational structure take?
  - Board of directors
  - Board of trustees
  - Senior management team
  - Executive committee
- Are multiple layers involved?
  - U.S.
  - International

# Plan Management and Operation

- Appoint committee members
- Define committee's terms of reference and guidelines for conduct
- Decide on procedural matters such as:
  - Frequency of meetings and quorum
  - Removal and replacement of members
  - Minutes and circulation
  - Conflict of interest and resolution
- Prepare annual governance report with summary checklist

# Plan Design

- Determine overall plan design
- Periodic review and confirmation
- Recommendations for design changes

# Legislative Compliance

- Monitoring legislative changes
- Government filings
- Review / maintenance of plan documents
- Investment compliance
  - Legislative
  - Investment policy

# Asset Management

- Develop investment policy
- Monitor investment performance
- Coordinate manager presentations
- Changes to managers

# Plan Funding

- Develop funding policy
- Remittance of contributions
- Review and reconciliation of financial statements with contribution remittances

# Administration

- Establish / monitor service standards
- Enroll members
- Maintenance of records
- Audit of benefit payments
- Plan expenses
- Review of forms and processes
- Interpretation of plan provisions

# Communication and Education

- Develop policy
- Review contribution rates and participation levels
- Review communication/education materials
- Identify education topics for future years
- Evaluate effectiveness of program

# Responsibility Chart

## The Pension Plan for Employees of XYZ Company

	Other Approvals*	Pension Committee	Human Resources	Consultant	Record Keeper	Investment Manager
<b>Plan Management and Operation</b>						
Appointment of Pension Committee Members and determination of terms of committee reference		Reviews and recommends	Completes task	Provides input		
Preparation of annual governance report – phase 1			Completes task	Provides input		
Review of annual governance checklist – phase 2 • Prepared by Pension Committee for Board of Directors			Completes task			
<b>Plan Design</b>						
Determination of overall plan design • DB vs. DC • DB accrual rate and employer DC matching percentage • Ancillary benefits		Reviews and recommends	Completes task	Provides input		
Periodic review and confirmation of design • comparison against stated plan objectives, • competitive market review, • comparison against survey data, • confirmation of number and choice of investment options		Reviews and recommends	Completes task	Provides input		
Recommendations for plan design changes • Plan amendments		Reviews and recommends	Completes task	Provides input		

# Effective Pension Governance

- Effective governance.....
  - is not a one-time project
  - requires constant monitoring, auditing and reviewing