Best Practices in Pension Plan Governance

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Agenda

1. Fiduciary Responsibility
   - Trust Law is the Basis of Governance
2. Best Practices in Oversight Committee Structure
3. Use of Experts or Independents on Oversight Committees
4. Process Tips:
   - Governance committee meetings
   - Minutes
   - Service Provider Contracts
   - Conflicts Management
1. Fiduciary Responsibility

The term "fiduciary" is derived from the Latin term for "faith" or "trust."

“A fiduciary is someone who has undertaken to act for and on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence.”

1. Fiduciary Responsibility

“The principle method for governing occupational pension schemes is trust law as amended by statute; trust law itself has been in continuous development for over 500 years.”

- Pension Scheme Governance—Fit for the 21st Century?
  NAPF Discussion Paper No 1, July 2005

The Lord Chancellor, Lord King

Sanford v. Keech (1726)
1. Fiduciary Responsibility

Fiduciary duty demands pristine conduct. It is more than a “do no harm” principle; it is also a “take no advantage” principle.

“The rule of equity which insists on those who by use of a fiduciary position make a profit, being liable to account for that profit, in no way depends on fraud, or absence of bona fides; or upon questions or considerations as whether the property would or should otherwise have gone to the plaintiff, or whether he took a risk or acted as he did for the benefit of the plaintiff, or whether the plaintiff has in fact been damaged or benefited by his action. The liability arises from the mere fact of a profit having in the stated circumstances been made.”

- Lord Wright, Regal (Hastings) Ltd v Gulliver [1942]
1. Fiduciary Responsibility

- It arises out of a power-dependency relationship
  “The key factual characteristics of a fiduciary relationship are: the scope for the exercise of discretion or power; the ability to exercise that power unilaterally so as to effect the beneficiary’s legal or practical interests; and, a peculiar vulnerability on the part of the beneficiary to the exercise of that discretion or power ...”
  - Indalex Limited (Re), Ontario Court of Appeal, 2011

- Pension administrators have fiduciary duties which they owe to plan “beneficiaries.”
  “The administrator shall administer the pension plan and pension fund as a trustee for the employer, the members of the pension plan, former members, and any other persons entitled to pension benefits under the plan.”
  - Pension Benefits Standards Act, 1985 (Canada)

- There is no difference between the statutory duty and the common-law duty.
  “Neither the content of the duty, nor the facts establishing whether it arose and whether it was breached, are different in the statutory or common law context. In short, the fiduciary duty imposed by the statute is indistinguishable from any fiduciary duty that might arise at common law.”
  - Lloyd v. Imperial Oil Limited (2008)
Fiduciary duty is the highest duty known to the common law

“A fiduciary duty imposes the highest duty in law on the party holding the duty – the fiduciary – to act altruistically for the sole benefit of the beneficiary, to the fiduciary’s own detriment if necessary.”

- Ben-Israel v. Valcare Medical (1997)
The Fiduciary Challenge

1. Fulfill the purposes of the trust including its terms
2. Act in good faith and loyalty to trust beneficiaries (plan members and employers):
   - Don’t take advantage of the position (not a do-no-harm principle)
   - “Manage” conflicts of interest
     - Cannot be “avoided” in our system
   - Protect trust assets
   - Act impartially, fairly balancing the interests of different classes of beneficiaries
3. Comply with statutory requirements
4. Adhere to the standard of care
5. Process matters!
   - Right process vs. right decision
Keys to Effective Governance

A. Board Structure
B. Board Members
   - Professional Trustees
   - Delegates
C. Process
“The composition, style, competence and effectiveness of a pension scheme’s governing body can make all the difference to the quality of decisions taken on investment, funding and administration and the extent to which members’ interests can be effectively promoted and enhanced.”

And ultimately it will affect the security—and adequacy—of the pensions received . . .”

— Pension Scheme Governance—Fit for the 21st Century?
NAPF Discussion Paper No 1, July 2005
A. Board Structure

1. Separate operational and oversight responsibilities

2. Appointment of board members
   - Suitability of Board Members
   - Professional trustees

3. Delegation and Expert Advice
   - Procurement and Contract Negotiation
   - Use of Professionals

4. Governance Mechanisms
   - Minutes
   - Other (reporting channels)
A. Board Structure

1. Separate operational and oversight responsibilities
   - Identify oversight responsibilities
     - Policy development
     - Strategy
   - Accountability
     - Established by legislation
     - Oversight board ultimately responsible
   - Organizational Charts
A. Board Structure—Sample

Founding Stakeholders
- Employer
- Employer & Employees

Oversight Board (ultimate responsibility)

Appointment and Performance Review Committee

Pension Committee
- Plan design
- Plan documentation
- Claims/appeals
- Regulatory compliance
- Communications

Finance Committee
- Investment policy
- Plan valuations [funding policy]
- Financial Disclosure
  - Accounting
  - Auditor

Ad hoc Committees
- Audit
- Ethics/conflicts

Operations
- Internal
- External

Investment Review Committee
- Regular monitoring
- Recommend investment policy

Ethics/Compliance Committee

Operations Committee
- Information technology
- Record keeping

Senior Management Committee
- Strategic direction & goals
- Recommend investment policy
- Recommend design changes

Service Providers
- Actuary
- Investment Manager
- Custodian
- Legal
- Accounting & Audit
- Administration
- Other
- Other
B. Board Members

Knowledge and Experience Counts

“A pension plan is a financial institution. The business of a defined contribution plan is not fundamentally different than a bank, a trust company or an insurance company that provides savings vehicles. The business of a defined benefit plan is not much different than an insurance company that provides life annuities . . . Except that in both cases, pension plans don’t have the same capital or reserve requirements, and the people who lead them do not have to be registered, licensed or qualified. Not anyone can run a financial institution. But anybody can run a pension plan, and pretty much anyone does. Generally the people responsible for registered pension plans are well intentioned. They often have expertise in finance or human resources, but no expertise in running a financial institution. For example, the enterprise value of Air Canada is about $5 billion. Its pension plan liabilities are about $15 billion. Who is responsible for Air Canada’s pension governance? Generally it is a group of professionals with a lot of expertise and sophistication in running an Airline, but no expertise in running a financial institution. From the perspective of any independent observer of the whole business, it’s not an Airline with a pension plan on the side, it’s a pension plan with an Airline on the side.”
B. Board Members

- Pension Literate
- Beneficiary Input
  - Employees, retirees, other beneficiaries, employer(s)
- Leadership
- Independence
- Demographic Background
  - Diversity
- Remuneration
- Skills and Experience
B. Board Members

- Skills and Experience
  - Pension industry experience
  - Trustee experience (Board experience)
  - Financial institution knowledge
    - Strategic planning
    - Risk management
    - Organizational management
    - Investment experience
  - Professional: legal, actuarial, audit, investment
B. Board Members

- Professional trustees (independent experts)
  - Independent (really!)
  - Functional assistance:
    - Oversight and operations
    - Selection/recruitment, succession planning, and assessment of
      - Other board members
      - Staff
      - Service providers
  - Evaluation of expert advice
    - Design suggestions
    - Policy development
    - Valuation issues
    - Legal advice
Delegation and Expert Advice

We complement each other. You enjoy doing work. I enjoy delegating.
Delegation and Expert Advice

- Tasks can be delegated, not responsibilities
  - To sub-committees
  - To internal staff
  - To external providers, e.g.,
    - Establishment of policies
    - Asset-liability assessment and management
    - Independent /non-conflicted views
- Do delegate operational duties
- Do delegate tasks requiring expertise
- Do be satisfied that all delegates have relevant qualifications and experience
Delegation and Expert Advice

- Reliance on experts is not a passport to relief
  - Actuary
  - Lawyer
  - Custodian
  - Auditor
Delegation and Expert Advice

Choose your experts well:

- “Mathematics possesses not only truth but supreme beauty—a beauty cold and austere, like that of a sculpture”
  - Bertrand Russell, *The Study of Mathematics*

- An actuary must be a mathematician, but a mere mathematician will be a very incompetent actuary
  - A. H. Bailey, President, Institute of Actuaries, 1880
C. Process—Documentation

- Properly document processes used to carry out fiduciary responsibilities.
  - Throughout the organization
  - Includes foundation, organization and policy documents

- Courts will defer to the trustees’ judgment—decision-making.
  - But need evidence
  - Keep proper minutes of trustee meetings to provide evidence.
C. Process: Minutes—Do’s and Don’ts

Do:

- List where the meeting takes place, along with the time and date it starts and ends
- List attendees and whether a quorum is present
- Note conflicts and resolution of conflicts
- Record all motions and the outcome of votes
  - Not proposers, seconders or who said what
- Be concise – it’s evidence, for and against.
  - Reasons for decisions? Briefly outline factors material to the decision, any dissenting views and the amount of time spent on discussion.
  - Indicate where actions are within the bounds of the foundation documents (plan, trust, legislation, relevant policies)
- Protect privileged advice
C. Process: Minutes—Do’s and Don’ts

Don’t:

¬ List the names of people who make and second motions
¬ Detail the debate over an issue, especially who said what
¬ Be shy about asking for clarification during the meeting
¬ Don’t wait to type up the minutes from your notes
C. Process: Procurement

¬ Procurement policies
¬ Evaluation
¬ Contracting (Negotiation)
  ¬ Structure
  ¬ Parties
  ¬ Pricing
  ¬ Representations and Warranties
    ¬ Systems and procedural prudence
  ¬ Responsibilities and Covenants
    ¬ Regulatory compliance
  ¬ Dispute Resolution
  ¬ Indemnities
Other Governance Mechanisms

1. Regular assessment of performance
2. Regular review of compensation mechanisms
3. Regular review of information processes
4. Management of conflicts
5. Protection of privileged advice
6. Internal audit procedures
7. Assessment of regulatory compliance systems
8. Risk-based controls
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<tr>
<th>Primary Legal Risk</th>
<th>Defined</th>
<th>Risk Conduct</th>
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<tbody>
<tr>
<td>Legislative (or regulatory) risk</td>
<td>The risk of failing to implement legislative or regulatory requirements.</td>
<td>• Failure to be or stay informed of legislation, regulation or policies</td>
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<td>Contract risk</td>
<td>Any risk that words used in the documents to support the pension promise that exposes the plan to undesirable contractual obligations.</td>
<td>• Use of non-standard terms &amp; conditions; • Technical fault: lack of appropriate documentation, inadequate/unclear authorisations; misstated promises made in supporting documents; Failure to enforce or to comply with plan terms</td>
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<tr>
<td>Non-contract rights risk</td>
<td>Failure to create or assert contract rights in contract development</td>
<td>• Failure to follow procurement procedures • Failure to negotiate appropriate contracts; e.g., fees on DC arrangements; ownership of plan records in administration contracts; appropriate service provider indemnities</td>
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<tr>
<td>Non-contractual obligations risk</td>
<td>Failure to address fiduciary or negligence risks.</td>
<td>• Failure to meet requisite standard of care; • Failure to review plan communications • Failure to use special skills or knowledge; • Inappropriate use or management of social media</td>
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<td>Dispute risk</td>
<td>The risk of operational or strategic errors in managing disputes.</td>
<td>• Failure to adhere to dispute resolution timelines or other mismanagement of the dispute process; • Inappropriate strategy or resolution process</td>
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Key Takeaways

1. Trust law dictates and informs governance
   • Act prudently
   • Take no advantage

2. Composition, style, competence and effectiveness . . . can make all the difference
   • Organizational framework
   • Effective oversight
   • Suitability of board members and delegates

3. Process is important
   • Plan documents, contracts, policies and minutes
Resources

1. The Pension Investment Association of Canada (PIAC) Governance Model.  
   (http://www.piacweb.org/publications/pension_governance/piac_governance_model/index.html)


3. Bank of Canada Pension Governance Policy. 22 September 2011  

4. Trustee Toolkit. A free, online learning program from The Pensions Regulator (UK) for trustees of occupational pension plans.  
   (https://trusteetoolkit.thepensionsregulator.gov.uk/arena/index.cfm)

5. CAPSA Guideline No. 4 Pension Plan governance guidelines and Self-Assessment Questionnaire.  
Questions?
Comments?