Practical Lessons in Pension Governance

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Overview

• Delegation and Supervision
• Conflict of Interest
• Pension Investments
• Communications
• Understanding Roles/Responsibilities
• Governance Review/Audit
Delegation and Supervision—Legal Obligations

- Administrator is responsible for administration/compliance and is required to do so in accordance with the standard of care set out in the *Pension Benefits Act* (Ontario) ("PBA") (s. 19 and 22, PBA)
- Administrator may employ agents to carry out acts related to plan administration or investment where “reasonable and prudent” (s. 22(5), PBA)
- Must personally select the agent, be satisfied of their suitability to perform the services, and ensure supervision of the agent is reasonable and prudent (s. 22(7), PBA)
- Employee/agents subject to fiduciary standards that apply to administrator under PBA (s. 22(8), PBA)
Prudent Delegation

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<td>Assess need to delegate</td>
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<td>If necessary, who is appropriate?</td>
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Delegation and Supervision

- Administrator wants to retain agent:
  - How selected?
  - Qualifications?
  - Contractual provisions
  - Contractual provisions
Delegation—Common Pitfalls

- Issues in the selection process
- The hand off
- Failure to negotiate certain contractual terms
- Inadequate documentation
Conflict of Interest—Legal Obligations

- A plan administrator is prohibited from knowingly permitting its interests to conflict with the administrator’s duties and powers with respect to the pension fund (s. 22(4), PBA)
- Also applies to employees/agents (s. 22(8), PBA)
- Plan administrator is not entitled to any benefit from a pension plan other than pension benefits, ancillary benefits and a refund of contributions [administrator also entitled to be paid from the fund reasonable fees/expenses re administration/investment of fund, subject to the plan documents and the PBA/regs] (s. 22(9), 22.1)
- Common law duty—no conflict of interest
- CAPSA Governance guideline—principle 10 (code of conduct and conflict of interest)—plan administrator should establish and document a code of conduct, incorporating a policy to manage conflicts of interest
  - Not law
Conflict of Interest

• Types of Conflicts:
  – Employer/Sponsor—“Two Hats”
  – Competing personal or other interests
Conflict of Interest

- Where there is a conflict what do I do?
- PBA does not address course of action
- Contrast with federal *Pension Benefits Standards Act, 1985* ("PBSA"):
  - 8(10) If there is a material conflict of interest between the role of an employer who is an administrator and their role in any other capacity, the administrator
    a) Shall, within thirty days after becoming aware that a material conflict of interest exists, declare that conflict of interest to the pension council or to the members of the pension plan; and
    b) Shall act in the best interests of the members of the pension plan
Conflict of Interest—*Indalex*

- Competing claims of a DIP lender and pension plan beneficiaries following the sale of Indalex in connection with insolvency proceedings
- SCC unanimously agreed breach of fiduciary duties occurred
- Indalex had a conflict of interest in its dual capacity as plan sponsor/administrator that it did not resolve
Conflict of Interest—*Indalex*

- Highlights need for greater attention to potential conflicts arising from exercise of plan sponsor functions
  - “Two hats” doctrine refined
- A range of possible actions/solutions to conflicts of interest are available—what is required depends on the circumstances
- Significance of conflict of interest is an important factor—extreme steps not always required
Conflicts of Interest—*Indalex*

- **Importance of:**
  - Substantive analysis of potential effect of any decisions on plan beneficiaries
  - Documenting decision-making process
  - Where necessary, measures to avoid conflicted decision making or at least independent representation of beneficiaries’ interests

- **Administrator must know when it is acting in sponsor vs. administrator capacity**
  - Understand scope of authority (powers and limitation) under each role
Managing Conflicts of Interest

- Always put best interest of members first
- PBA s. 22(4)—prohibition on knowingly permitting a conflict
- Follow requirements of any relevant governance documents/policies, e.g., code of conduct, SIPP, charter/terms of reference
- When in doubt, disclose!
  - Key to resolving conflicts is disclosure, and objectivity in decision making
Pension Investments—Legal Framework

• The plan administrator is responsible for the proper investment of the pension fund

• Investment duties include:
  – Compliance with quantitative limits under Schedule III to the federal *Pension Benefits Standards Regulations, 1985*
  – Statement of Investment Policies and Procedures
  – Ensure that assets of the pension fund are invested in a prudent manner in accordance with the standard of care in s. 22 of the PBA
Investments: Primary Obligation—
Prudent Investment of Fund

• s. 22 of PBA requires an administrator to:
  – 22(1)—exercise care, diligence and skill in the investment of a pension fund that a person of ordinary prudence would exercise
  – 22(2)—also use all relevant special knowledge and skill
  – 22(5)—(may) employ “agents” to assist in the investment of the pension fund, where it is reasonable and prudent in the circumstances to do so
  – 22(7)—if use agents must personally select agent, be satisfied of suitability to perform task and carry out such supervision as is prudent and reasonable
  – 22(8)—employee or agent is subject to same standards

• CAPSA Guideline No. 6—Pension Plan Prudent Investment Practices Guideline
What is Prudent Investment?

- Prudence is process driven, not results oriented
  - “The prudent person rule focuses on behaviours and processes rather than solely on outcomes.” [CAPSA Guideline No. 6—Pension Plan Prudent Investment Practices Guideline]

- Exercise due diligence
  - “In the pension investment context, a key element of the Prudent Person Rule is that fiduciaries should exercise due diligence. This includes making decisions based on proper consideration of adequate information, documenting the final decision, documenting the reasons for the decision and documenting the circumstances that were considered” [CAPSA Guideline No. 6]

- Prudent portfolio approach
  - “...the “prudent person portfolio approach” recognizes that risks that would be unsupportable for an individual investment may be suitable for a well diversified portfolio” [OSFI Investment Policy Guideline, April 2000]
What is Prudent Investment?

- FSCO Investment Monitoring Consultation Paper, July 2004:
  - “... what is emerging from case law is that proper investment management requires that the persons responsible for such activities satisfy a certain standard of care, diligence and education in making their decisions, and that investment activities reflect the best information available on how to manage the assets under their supervision”.

- An administrator has two main categories of investment duties:
  - Selection of investments/managers
  - Supervision of managers and other delegates
Pension Investment—Role of Administrator

- How much is enough?
- How much is too much?
  - Regulator expectations
  - Materiality
Investments—Administrator Perspective

• Tools to assist administrator in meeting legal obligations regarding investments:
  – Compliance checklists
  – Expert advice
  – Risk assessments
  – Due diligence reports
  – Legal opinions
  – Compliance certificates
Pension Investment—
R. v. Christophe

Background
• Plan investment caused the plan to lose significant amount of money
• Criminal prosecution of trustees (as pension plan administrator) and investment committee members (delegates)
• Defendants not guilty of breaching prudence standard but trustees fined for failure to supervise investment committee

Lessons
• Due diligence is key to prudent investment
• Supervising agents, delegation and governance structure key to avoiding liability
• Expert vs. non expert directors
Communications—Legal Framework

- Pension Standards Legislation
  - PBA fiduciary duty s. 22
  - Specific communications to plan members required include:
    - Member booklets
    - Annual statements
    - Termination statements
    - Spousal waivers
  - Employer duties s. 25(3)
- Common Law—duty to disclose
- Regulatory Policies
  - Do not have the force of law, but compliance is expected
Communications

• CAPSA Guideline No. 4:
  – “The plan administrator should establish a communication process, taking into account both fiduciary and other responsibilities, so that plan members, beneficiaries and other stakeholder have access to information about the plan as required by applicable legislation. In addition, the plan administrator should consider what, if any, other information about the plan will be made available to plan members, beneficiaries and other stakeholders.”
Communications—Governance Considerations

- Part of administrator’s duty is to provide relevant information to members; must be done pro-actively.
- Employee communications form part of the “legal matrix” upon which rights under the plan are to be determined (Schmidt) and may give rise to legal claims.
- Highlights need for clear, accurate communications and risk management strategies/policies.
Communications—Governance Considerations

- Best practices include:
  - Establish communications policy
  - Balance risk management vs. members’ need for information
  - Ensure “plain language” communications
  - Make information available, accessible and understandable
  - Be proactive and not just reactive
  - Clear disclaimers may mitigate risk (e.g., *Burke v. HBC*)
    - However, over-reliance on waivers/releases or vague or overly technical language will not be effective (e.g., *Dawson v. Tolko*)
Understanding Roles/Responsibilities

- Under the PBA, the plan administrator has responsibility for compliance (s. 19)
- Where the administrator is the employer, generally Board of Directors is ultimately responsible
- Others?
Delineating Roles/Responsibilities

- Various players involved in plan governance with varying duties/responsibilities
- Need to clearly describe and document the roles of all those involved in the governance of the pension plan to ensure effective governance
- Accountability matrix
  - Who fits where? Who is reporting/accountable to whom? Who has responsibility for what? Decision making authority?
Understanding Roles/Responsibilities—Common Pitfalls

- Inadequate documentation
- Inadequate reporting/oversight
- Lack of communication to participants in governance process
Governance Review/Audit

- Prudent?
- CAPSA Governance Guideline Principle 11: Governance Review:
  - The plan administrator should establish and document a process for the regular review of the pension plan’s governance framework and processes
Legal Governance Review—
Common Issues

- Non-compliance with various tax/pension standards rules in pension plan documents
- Lack of documentation delegating/reporting/accountability
- Terms of Reference/Charter
- Policies (or lack thereof)
- Fiduciary insurance/indemnification
- Inadequate documentation with third party service providers
Key Takeaways

Governance Best Practices

• When acting in fiduciary capacity, must always act in best (financial) interest of members

• In carrying out its powers, duties and responsibilities, should consider the following 3 part test:
  1. Are you acting in sponsor vs. fiduciary capacity
  2. If acting in a sponsor capacity, could doing so trigger any fiduciary responsibility?
  3. If there is a potential conflict, how should it be resolved?

• The key is demonstrating prudence (i.e., process driven, rather than based on results)
  – Always document final decisions, reasons for the decision and circumstances that were considered