

IDENTIFICATION OF “BEST PRACTICES” FOR THE GOVERNANCE AND ADMINISTRATION OF PENSION PLANS

A. Governance Overview

Pension plan governance refers to the system used to organize the roles and responsibilities of all persons in respect of a pension plan. In general, good governance promotes the timely and cost-effective delivery of benefits and, at the same time, promotes the administration of the plan in the best interests of the plan members and beneficiaries.

The importance of and the requirement for high standards of pension fund governance and guidelines in Canada has been brought to the forefront by such organizations as the Office of the Superintendent of Financial Institutions Canada (OSFI), and the Pension Investment Association of Canada (PIAC). Their guideline describes best practices for the governance of pension plans, and the responsibilities of plan administrators. Best practices embody:

1. Clearly stated objectives
2. Independence of the governing body from the plan sponsor
3. Separation of governance from administrative operations
4. Clearly defined roles, responsibilities, policies, fiduciary duties, and reporting requirements for all parties
5. An understanding that tasks may be delegated, but not responsibilities
6. Ensuring pension committee effectiveness
7. Accountability, internal controls, performance measurement and reporting
8. Risk identification and mitigation
9. Adequate knowledge and skill sets
10. Due diligence in decisions and the supervision of delegated work
11. Controls for expenses and protection from conflicts of interest
12. A code of ethics
13. Transparency and full disclosure
14. A process of governance self-assessment

Of the various roles that must be clearly defined it is especially important that the governance document explicitly identify who is responsible for each of the following areas:

1. Oversight and monitoring
2. Pension management
3. Compliance with legislation
4. Plan funding
5. Asset management
6. Benefit administration

7. Information and reporting requirements
8. Communication

Without responsibilities being clearly defined important work may not get done, overlap can occur and it is extremely difficult, if not impossible, to hold participants accountable.

To ensure due diligence and best practices in pension plan governance there must be processes and criteria in place to allow the individuals responsible for the governance of the plan to assess the effectiveness of the plans' governance, and the individuals involved in it, on a regular basis. The exercise of due diligence is especially important in obtaining third party services.

A governance model is developed for the purpose of setting out clearly the responsibility and accountability of those involved in the governance of pension plans. The cornerstone of a pension governance process is that it must recognize, reflect and facilitate the discharge of fiduciary duty.

The pension promise embedded in the provisions of the plans is the starting point for providing proper pension plan governance. Proper pension plan governance is a critical feature of delivering on the pension promise. Whether explicit or implicit, the pension promise must address three critical issues:

1. The pension entitlements
2. The funding policy chosen
3. The provisions for management oversight

In summary, the governance structure for pension plans should be centered on the pension promise and the management of assets to meet the liabilities associated with the pension promise. The governing body has a fiduciary duty to the plan's beneficiaries to ensure that the pension promise is fulfilled. The selection of people for the governing body is critical. Each must be knowledgeable, be willing to accept the responsibilities of fiduciary duty, and be independent of management of the pension fund.

B. Pension Committee Effectiveness

The effectiveness of the Pension Committee can be enhanced by employing the following best practices:

1. Ensure the Pension Committee's mandate, duties and responsibilities are understood by all committee members.
2. Determine the information needs of Pension Committee members in order for them to carry out their oversight and monitoring responsibilities within a framework of "best practices".
3. Set goals with expected outcomes to address certain priority items on an annual basis.

4. Ensure an effective and accountable process is in place for setting meeting agendas
5. Clearly define the desired outcomes of Pension Committee meetings
6. Focus on decision-making by changing the meeting format from simple reporting to promoting more action
7. Meetings are goal driven, emphasizing action, with every agenda item linked to a goal
8. All action items have the associated leadership, responsibilities, deliverables, necessary resources and timelines specified
9. Ensure metrics are in place to provide clear evidence of success or failure
10. The Pension Committee reviews its size, composition, expertise, terms and mandate annually
11. Put an orientation program in place for new Pension Committee members to assist them in executing their fiduciary and governance duties.
12. Provide learning opportunities on specific technical issues that will allow the Pension Committee members to make more informed and robust decisions
13. Conduct a self-assessment of the Pension Committee's effectiveness annually
14. Ensure the independence of governance from management is preserved at all Pension Committee meetings using "best practices"

C. Fiduciary Duties and Responsibilities

An understanding of pension plan fiduciaries and their fiduciary duties and responsibilities is essential in building a governance framework based on best practices.

A person is a fiduciary with respect to a plan to the extent;

- (i) He/she exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets.
- (ii) He/she has any discretionary authority or discretionary responsibility in the administration of such plan.

Fiduciaries are in a power relationship with beneficiaries. The fiduciary relationship is the highest level of obligation at law.

The fiduciaries of a pension plan include:

1. Board of Governors
2. Pension committee members

3. Pension plan administrator
4. Investment Managers
5. Advisors (lawyers, consultants)
6. Custodial Trustee
7. Agents, service providers
8. Those persons involved the disposition of the assets or funds related to the plan

The fiduciaries of a pension plan have obligations that include:

1. All members/beneficiaries must be treated equitably
2. Acting in the best long-term interests of plan members and beneficiaries
3. Maintaining a reasonable rate of return across the entire portfolio within accepted levels of risk
4. Maintaining adequate diversification within accepted risk parameters
5. Collateral interests of beneficiaries as employees, and third parties may be considered, but subordinate to beneficiaries' interests

D. Clearly Defined Responsibilities and Accountability

The pension governance structure must provide a best practices based description of the duties, responsibilities and reporting structures for all pension governance related parties including:

- Board of Governors
- Pension committee of Board
- Sponsor of pension plan
- Pension plan Administrator
- Investment Policies and Procedures
- Committees defined in pension plan text
- Investment Managers
- Custodial Trustee
- Actuary
- Auditors
- Advisors (lawyers, consultants)
- Agents, Service Providers
- Those involved in the disposition of assets or funds related to the pension plan

E. Pension Administrator's Responsibilities

The administrator is generally responsible for the administration and investment of the pension plan in accordance with applicable pension laws and plan documents. A fiduciary has the duty not to delegate decision-making power. Administrative responsibilities include:

- a) Determine and document who is responsible for what components
- b) Determine and document the chain of delegation
- c) Circulate to all participants in the pension governance process the components, responsibilities and reporting relationships
- d) Provide ongoing training and education to ensure that any person involved in the administration or investment of the pension plan or fund has or acquires the knowledge and skills appropriate for his or her role
- e) Regularly review the assigned roles and responsibilities and update

F. Some Governance Objectives

- a) Provide goals for the administration of the plan such as:
- b) Making all contributions and paying all benefits in a timely manner
- c) Performing internal self-assessment of the organization's pension governance at regular intervals (at least once a year)
- d) Documenting all key decisions
- e) Communicating all relevant information to members in a timely manner
- f) Having an external governance audit performed on the pension plan at regular set intervals (at least once every five years)

G. Communications

- a) Implementation of Web-based pension information resources
- b) Regular newsletters to members
- c) An annual report to members on pension governance
- d) An annual report to members, on the general state of the plan, that provides for openness, transparency and accountability. Plan performance, experience and expenses charged against the plan information should be especially clear to a plan member. The overall format and contents of the annual report are to be based on best practices