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The Evolution of Pension Governance in Canada

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Overview

Trends in Canadian Pension Governance:

1. Increased Regulation of Governance
2. Conflicting Sponsor-Fiduciary Duties in the Cross-hairs (“Two Hats” Doctrine post-*Indalex*)
3. Mandatory Joint Governance the next step?

Governance Defined

CAPSA Guideline No. 4: Pension Plan Governance Consultation Draft (Revised)

- “Pension plan governance is about delivering on the pension promise consistent with the pension plan documents and pension legislation. Pension legislation defines the pension **plan administrator as the body responsible for the governance of the pension plan.**”
- “Pension plan governance refers to the structure and processes in place for the effective administration of the pension plan to **ensure the fiduciary and other responsibilities of the plan administrator are met.**”

Alberta Guideline #12: Governance, Investment and Funding Policies

- “Governance is **the process which determines who has the power, who makes decisions**, how other players make their voices heard and how accountability is achieved.”

Governance as a Component of Legal Duties

Alberta Guideline #12: Governance, Investment and Funding Policies

- “In the establishment and maintenance of a pension plan, a **properly operating governance structure is required given the implied trust and the fiduciary relationship between the administrator and the plan members.**”

Pension Legislation and Governance

- Legislation specifies who may be the administrator of a pension plan and identifies the administrator’s general legal (fiduciary) duties
- Otherwise governance is not regulated by specific rules or minimum standards (not part of the PBA lexicon)
- Instead, governance is “regulated” as part of fiduciary duties:
 - Common law duty of loyalty and prudence
 - Statutory duty of prudence in the selection and monitoring of delegates
- Specific requirements of governance addressed primarily in regulatory policies

CAPSA Guideline No. 4 – Governance Principles

- First released in 2004 and recently released updated Consultation Draft in 2016
- Governance Principles include:
 1. **Fiduciary responsibility**
 2. Governance framework
 3. **Roles and responsibilities**
 4. **Performance monitoring**
 5. Knowledge and skills
 6. Access to information
 7. Risk management
 8. Oversight and compliance
 9. Transparency and accountability
 10. Code of conduct and conflict of interest
 11. Governance review
- Revisions intended to clarify when a fiduciary relationship exists and what obligations flow from such relationships, including that fiduciary responsibility is retained when any activities are delegated to third parties

1. Increasing Regulation of Governance

- Increased regulation a low bar, because historically there has been little or no regulation of governance in Canada:
 - Governance principles/guidelines/best practices adopted by industry associations and umbrella regulatory organizations (CAPSA)
 - CAPSA Guidelines aren't direct regulatory policies, have to be adopted by each provincial regulator
 - Legal implications of not following Guidelines?
 - Some have reasoned that a failure to follow such Guidelines is *prima facie* evidence of a failure to act prudently
- Now seeing signs that this is beginning to change...

Increasing Regulation of Governance

- Recently updated CAPSA Governance Guidelines
- Recent pension reforms are now beginning to provide for regulation of certain aspects of governance
- Specific requirements to establish and maintain governance and funding policies in Alberta and BC, among others:
 - Content not overly prescriptive
 - Don't need to file (but must have them available for inspection)
 - Governance policies must be in place and can be examined, reviewed and enforced by the regulators in these provinces
- Pension reforms mandating member involvement in governance (joint governance) for certain plans

Increasing Regulation of Governance: Recent Alberta/BC Pension Reforms

- Requirement for a written Governance Policy for all pension plans, as well as:
 - Statement of Investment Policies and Procedures (SIPP)
 - Funding Policy
- Governance Policy must:
 - Set out the structures and processes for overseeing, managing and administering the plan and explain what they are intended to achieve
 - Identify all participants who have authority to make decisions in those structures and processes, and describe their roles, responsibilities and accountabilities
 - Set performance measures and establish a process for monitoring performance of participants against those performance measures
 - Establish procedures to ensure that the administrator and any other participants in governance have access to relevant, timely and accurate information
 - Establish a code of conduct for the administrator and a procedure to disclose and address conflicts of interest of the administrator
 - Identify the material risks that apply to the plan and establish internal controls to manage those risks
 - Establish a process for the resolution of disputes involving members and other persons who are entitled to benefits under the plan

EPPA (Alberta) Regulations, s. 53; and PBSA (British Columbia) Regulations, s. 50

Increasing Regulation of Governance: Recent Alberta/BC Pension Reforms

- Administrator required to assess the administration of the pension plan regularly, including the:
 - plan's compliance with the Act and regulations;
 - **plan's governance**
 - funding of the plan
 - investment of the pension fund
 - performance of the trustees (if any)
 - performance of the administrative staff and any agents of the administrator
- Administrator must prepare a written assessment, retain it, and make it available to the Superintendent on request.

Section 41 of BC PBSA and Alberta EPPA

Increasing Regulation of Governance: – Other examples

- **Ontario SIPP**
 - Must now be filed and must include consideration of ESG factors
- **Newfoundland Public Sector Pension Reforms**
 - Agreement between government and public sector unions results in changes to plan administrator/governance structure
 - Introduces joint trusteeship model
 - Independent not-for-profit corporation established to oversee the administration of the plan and investment of plan assets
- **Nova Scotia Public Sector Plans**
 - Joint trusteeship introduced – Public Service Superannuation Plan Trustee Inc. (PSSPTI) assumed fiduciary responsibility from the Minister of Finance
 - PSSPTI composed of directors representing both employers and employees
 - Prescriptive funding policy embedded in new governance structure
- **New Brunswick Shared Risk Plans**
 - Requirement for independent plan administrator (board of trustees, trustee or non-profit corporation; legislation specifies that trustees must act independently)
 - Risk management requirements (prescribed risk management requirements that must be attained when plan is established and at certain times)

2. Managing Conflicting Legal Duties

- Pension legislation recognizes two distinct roles in relation to pension plan governance:
 - Plan administrator – fiduciary
 - Plan sponsor – non-fiduciary (typically the employer or a union)
- Pension legislation also allows the employer to act as both administrator and sponsor for many plans
 - Single employer plans (DB and DC)
 - Private sector (not as common in public sector plans)
- “Two hats” doctrine developed from case law (*Imperial Oil*, 1995) to provide a framework for managing potential conflicts between sponsor role and administrator role
 - As long as you keep your roles distinct, there should be no breach of the PBA or common law due to conflict of interest

Managing Conflicting Legal Duties: “Two hats” Doctrine

- **Plan amendments/termination**
 - Sponsor can amend
 - Administrator role confined to ensuring compliance with laws, communications to members
- **Investments**
 - Administrator (fiduciary) function
 - Murkier in DC – if sponsor established plan with unlimited investment options, can the administrator change it?
- **Plan Funding Decisions**
 - Funding typically a sponsor decision (how much to contribute) subject to statutory minimum requirements.
 - But setting assumptions and appointing/directing the actuary is a role assigned to the administrator under pension legislation. Fiduciary?
 - Funding Policies adopted to try to provide better understanding/clarity of these potentially conflicting roles

Managing Conflicting Legal Duties: *Sun Indalex Finance, LLC v. United Steelworkers* (2013) (SCC)

- Supreme Court of Canada decision calls into question the ongoing validity/utility of the “two hats” doctrine:

“...where an employer’s own interests do not converge with those of the plan’s members, it must ask itself whether there is a potential conflict and, if so, what can be done to resolve the conflict. **Where interests do conflict, I do not find the two hats metaphor helpful.** The solution is not to determine whether a given decision can be classified as being related to either the management of the corporation or the administration of the pension plan. ... **An employer acting as a plan administrator is not permitted to disregard its fiduciary obligations to plan members and favour the competing interests of the corporation on the basis that it is wearing a “corporate hat”.** What is important is to consider the consequences of the decision, not its nature. ...

When the interests the employer seeks to advance on behalf of the corporation conflict with interests the employer has a duty to preserve as plan administrator, a solution must be found to ensure that the plan members’ interests are taken care of. ... The solution has to fit the problem, and the same solution may not be appropriate in every case.” [Emphasis added.]

- Majority of SCC accepted PBA scheme contemplates employer can have dual role and potential conflicts can arise. However, Indalex could **not disregard** potential conflicts when wearing its “corporate hat”
- Does *Indalex* suggest an end to the “two hats” doctrine? What are the implications for administrators and other plan fiduciaries?

Managing Conflicting Legal Duties: Pension Governance after *Indalex*

- **CAPSA Guideline No. 4: Pension Plan Governance Consultation Draft (Revised)**

“Many individuals who have pension plan governance responsibilities also have responsibilities to the plan sponsor. Consequently, those with governance responsibilities must clearly understand the different roles and responsibilities for each. ... In particular, whenever the two roles are in a conflict of interest, the administrator must act in the best interests of plan members and beneficiaries.”

- Requiring adoption of governance policies (including funding policy) to address potential conflicts of interest
- Mandatory joint governance

3. Joint Governance

- Is joint governance the next stage in the evolution of pension governance?
- What is joint governance?
 - Members (or unions) and employers have rights to appoint the trustees or other managing fiduciaries of the plan
 - Sometimes called “jointly trustee” plans
- As a trade off for relaxation of funding rules/no solvency funding or for the ability to vary DB benefits from time to time, it is argued that members should have a say in how this is to be done and therefore should have a roll in appointing the members of the governing body of the plan

Mandatory Joint Governance for Certain Plans

- Target Benefit Plans
 - Federal Consultation Paper (2013)
- Jointly Sponsored Pension Plans (JSPPs)
 - Ontario Public Sector
 - Newfoundland Public Sector
 - Nova Scotia Public Sector
- Contrast this with the “independent trustee” approach adopted in New Brunswick for shared risk plans

Joint Governance and Fiduciary Decision Making

- Fiduciary duties require the plan fiduciaries to, among other things, act in the best interests of the plan members and to act with an even hand in dealing with different classes of members.
- All trustees must put aside their sponsor interests and act only in the best interests of plan members
 - Does this solve the potential for conflict?
 - If trustees can't act as the representatives for sponsors, or particular groups of members, then what is the point?
- Experience with jointly governed plans (e.g. Ontario and BC JSPPs) has been very positive, which is perhaps driving this initiative

Joint Governance and Fiduciary Decision Making

- How to reduce benefits under a pension plan?
 - Pro rata or pay retirees in preference?
- *Neville v. Wynne* (2006) (BCCA)

“Pension Plans are complex financial structures in which disparate plan members, each with his or her individual characteristics and needs, are bound together in a scheme to serve the retirement needs of all. By necessity, the scheme is unlikely to meet all of the needs of its participants. Each of the participants may be affected differently by changes in benefits. ... Whenever this occurs, some of the members of the plan—sometimes all—will be disadvantaged by the change. In other cases, the changes will be beneficial to some and detrimental to others. This creates a particular problem for trustees of pension plans. The impact of the trustees’ decisions will never be equally distributed among the beneficiaries of the plan. Accordingly, **it is impossible to enforce equity by demanding equality of treatment. It must be left to the trustees to navigate these shoals and determine the nature of the change that will achieve a fair result.**”

Joint Governance and Fiduciary Decision Making

- Courts will generally defer to trustees' exercise of discretion in the absence of evidence of bad faith, a failure to act or taking into account irrelevant factors
- If board members/trustees are understood to represent the interests of those who nominated them, can they be independent?
- *Neville v. Wynne* (2006) (BCCA)
 - “Pension plans typically attempt to balance the composition of the Board of Trustees administering the plan by requiring that they be elected or appointed by persons having different interests in the plan. This is the case in the Plan before me. Some members of the Trustees are appointed by the employers and some elected by members of the Union. **This representative character ensures, to some extent, that their decisions will take into account the disparate interests of the beneficiaries.**”

Joint Governance and Fiduciary Decision Making

- What role do the plan documents play in setting priorities?
- *Burke v. Hudson's Bay Co.* (2010) SCC
“The duty of even-handedness must be anchored in the terms of the pension plan documentation. It does not operate in a vacuum. The duty of even-handedness requires that where there are two or more classes of beneficiaries, each class receives exactly what the terms of the documentation confer. In its role as pension plan administrator, HBC was a fiduciary and had fiduciary obligations. However, just because HBC has fiduciary duties as plan administrator does not obligate it under any purported duty of even-handedness to confer benefits upon one class of employees to which they have no right under the plan.”

The Future of Governance?

- Other possible directions:
 - Trustee independence requirements
 - New Brunswick
 - The Australian experience
 - Expanding the scope of fiduciary responsibility to agents, advisors and service providers of the administrator
 - US experience
- Questions?