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THE EVOLUTION OF GOVERNANCE

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The term governance has become pervasive in legal parlance. In the corporate context, companies and their boards of directors have been forced to re-examine their governance practices following high profile examples of corporate governance failures, such as Enron Corporation and, more recently, Volkswagen and its emissions scandal.

In the pension context, high profile pension governance failures have been more scarce, but there has nevertheless been an increased focus on pension governance over the past 10 to 15 years. Pension plans should exercise good governance – but what does that mean? The Canadian Association of Pension Supervisory Authorities (CAPSA)[2] describes pension plan governance in its Guideline No. 4 as follows:

> "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."[3]

This paper will focus on certain trends in the area of pension governance. First, we will discuss the increasing regulation of governance. Then we will look at joint governance and whether it is or should be the next stage in the evolution of governance. Finally, we will examine the issue of managing conflicting legal duties in the post-*Indalex* era.

INCREASING REGULATION OF GOVERNANCE

When governance issues first came into focus for pension plans, they were not generally a product of regulation or legislation. Instead, CAPSA issued guidelines on various governance matters. CAPSA's Guideline No. 4 (Pension Plan Governance Guidelines) was first issued in June, 2005.[4] This represented the first major step by regulators across the country to wade into the governance realm.[5] However, CAPSA's guidelines are not law (at least not in the sense of a legal minimum standard). They are seen as a best practices guideline. Accordingly, "compliance" with these guidelines is not, strictly speaking, a legal requirement.[6]

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[2] CAPSA defines itself as "a national interjurisdictional association of pension regulators whose mission is to facilitate an efficient and effective pension regulatory system in Canada. It develops practical solutions to further the coordination and harmonization of pension regulators across Canada."

[3] CAPSA Guideline No. 4: Pension Plan Governance Consultation Draft (Revised) ("Draft CAPSA Guideline No. 4").

[4] In this guideline, there are 12 governance principles discussed: Fiduciary responsibility; governance framework; roles and responsibilities; performance monitoring; knowledge and skills; access to information; risk management; oversight and compliance; transparency and accountability; code of conduct and conflict of interest; governance review.

[5] Pre-dating CAPSA's Governance Guidelines were governance principles/guidelines developed by industry organizations and regulators. See Pension Investment Association of Canada, *Effective Pension Plan Governance* (Toronto: Pension Investment Association of Canada, 1997), The Association of Canadian Pension Management, *Governance of Pension Plans* (Toronto: The Association of Canadian Pension Management, 1997), Canada, Office of the Superintendent of Financial Institutions, *Guidelines for Governance of Federally Regulated Pension Plans* (Ottawa: Office of the Superintendent of Financial Institutions, 1998).

[6] We note, however, that as these guidelines are published by a joint organization composed of regulators from across the country, they arguably set out best practices. An organization should certainly strive to incorporate CAPSA's recommendations.

More recently, however, we have seen legislators start to provide for regulation of certain aspects of pension governance. This is arguably the most pronounced in the recent pension reforms implemented in Alberta and British Columbia. [7] Both jurisdictions have now introduced specific requirements for all pension plans to establish and maintain governance policies and for defined benefit and target benefit plans to establish and maintain funding policies. Although these policies do not have to be filed with the regulator, the policies have to be in place and can be examined, reviewed or enforced by the regulators in these provinces. [8] The regulations in Alberta and British Columbia set out detailed requirements for what must be included in a governance policy. [9] In order to comply with these requirements, the plan administrator must have a comprehensive understanding of the governance processes and measures in place. It goes without saying that the governance document must be an accurate reflection of the governance processes and measures for the plan.

The Alberta and British Columbia legislation further require the administrator to assess the administration of the plan regularly.[10] This includes assessing the plan's compliance with the relevant statute and regulations; the plan's governance; the funding of the plan; the investment of the pension fund; the performance of the trustees (if any), and; the performance of the administrative staff and any agents.[11] This assessment must be done in writing and must be made available to the regulator upon the regulator's request. As this is a key governance assessment required by legislation in these provinces, it is our view that this should be done with the assistance of outside counsel and involve the preparation of a formal report.

Another example of governance regulations is apparent in the shared risk regime in New Brunswick. In this regime, there are prescriptive risk management requirements that must be satisfied. Further, there is a requirement for certain additional pension related documents, including a funding policy, which must be filed with the regulator. The funding policy requirements in New Brunswick for shared risk plans are also quite prescriptive. To try to ensure diligent and ongoing governance reviews, the New Brunswick shared risk regime also contains annual review and filing requirements.

The Quebec government has also steadily increased the governance requirements for Quebec-registered pension plans. Since 1990, Quebec-registered plans must be administered by a pension committee (i.e., board of trustees) composed of at least one individual designated by active plan members, one individual designated by the inactive plan members (i.e., retirees and deferred members) and beneficiaries, and one independent member. A committee must hold a meeting annually for plan members and beneficiaries to report on the administration of the plan. Since 2007, a committee is also required to adopt internal by-laws establishing the rules of operation and governance and, more recently, the government introduced a requirement to establish and maintain funding policies for defined benefit plans.[12]

Critics of increasing regulation of governance argue that a principles based approach is sufficient and that plan administrators, as fiduciaries, are bound to act prudently and in the best interests of plan beneficiaries, which would include ensuring good governance practices. On the other side of the coin, it may be argued that some plan administrators require more prescriptive rules to follow and that having such rules in place helps to protect plan beneficiaries. Whether you are in favour of increased regulation of governance or not, in our view it is certainly clear that there has been a trend

[7] See *Pension Benefits Standards Act*, SBC 2012, c 30 ("PBSA"); Employment Pensions Plans Act, SA 2012, c E-8.1 ("EPPA").

[8] Note also that the funding policy is required to be provided to the plan's actuary.

[9] See EPPA (Alberta) Regulations, s. 53 and PBSA (British Columbia) Regulations, s. 50.

[10] EPPA (Alberta), s 41(1) and PBSA (British Columbia), s. 41(1); the assessments must be carried out for the first time within one year after the end of the 2nd fiscal year of the plan; after that, an assessment must be carried out within one year after the end of each subsequent 3rd fiscal year of the plan, EPPA (Alberta) Regulations, s. 52, PBSA (British Columbia) Regulations, s. 49.

[11] EPPA (Alberta), s. 41 and PBSA (British Columbia), s. 41.

[12] Sections 142.5, 147, 151.2 of the Quebec *Supplemental Pension Plans Act.*

towards regulators now attempting to regulate governance as a minimum standard.

JOINT GOVERNANCE

Historically, single employer sponsored pension plans have been administered by the sponsoring company. There are, however, other administration models for pension plans. Joint governance is a term generally used to describe pension plan administrators that include appointees of both the members (or unions) and the employers.[13] As pension designs evolve, and funding rules are relaxed or varied, an argument may be made for increased member involvement in the governing body of the pension plan.

Ontario's jointly sponsored pension plans (JSPPs) have been described as being extremely well run pension plans.[14] These plans are set up such that members and employers participate in plan governance. JSPPs are required under the regulations to Ontario's *Pension Benefits Act* to satisfy certain criteria. For example, the regulations require that the employers and the members must be jointly responsible for making all decisions about the terms and conditions of the pension plan and any amendments to the pension plan. These are sponsor type roles. Further, the employers and the members must be jointly responsible for making all decisions regarding the appointment of the administrator of the plan or the appointment or selection of the persons who would constitute any administrator body for the plan.[15] In certain other recent public sector reforms, we have seen a move toward a jointly governed board as part of a package of reforms to the plan design.

Shared risk plans (SRPs) in New Brunswick have different administration requirements from other plans in the province. These plans are required to be administered by a trustee, board of trustees or non-profit corporation.[16] In our experience, and although not required under the legislation, these plans are generally administered by boards of trustees, with union/member appointees and employer appointees. In our view this is appropriate given the plan design. As the shared risk design removes most of the funding risk from the employer, it is arguably appropriate that members have more of a say in the plan governance.

Effective joint governance requires the plan trustees to act in accordance with their duties as fiduciaries of the plan. That is, they must, among other things, act in the best interests of the plan members and with an even hand in dealing with different classes of members. Trustees must put aside their sponsor interests and act only in the best interests of plan members. We note that in New Brunswick this requirement has been entrenched in the SRP legislation.[17]

As mentioned above, there is a limited form of joint governance in Quebec through the mandatory participation of at least 2 member-appointed individuals on pension committees of a Quebec-registered pension plan. In our experience, this requirement has generally not affected the ability of a plan sponsor to control the administration of its plan, and it has been effective in increasing transparency and ensuring that plan members have an opportunity to voice their concerns on a regular basis.

One argument in favour of joint governance is that it can help avoid the two hats problem that can arise where an employer is both the plan sponsor and the administrator. This issue is discussed in more detail below. We know from discussions with various single

[13] Joint governance is sometimes referred to as "jointly trusteed".

[14] See e.g. Susan Yellin, "Jointly Sponsored Pension Plans Nurture Good Governance" The Insurance and Investment Journal, 2014 http://insurance-journal.ca/article/jointly-sponsored-pension-plans-nurture-good-governance/; Jana Steele & Ian McSweeney, "Myth # 1: Target Benefits are a New "Untested" concept" 2014, Canada Pensions & Benefits Law; For examples of JSPPs, see Pension Plan for the Employees of the Ontario Public Service Employees Union (339861) Colleges of Applied Arts and Technology Pension Plan (number 589895), Healthcare of Ontario Pension Plan (number 346007), OMERS Primary Pension Plan (number 345983), Ontario Public Service Employees' Union Pension Plan (number 1012046), Ontario Teachers' Pension Plan (345785) Toronto Transit Commission Pension Fund Society (317586).

[15] R.R.O 1990, Regulation 909, section 3.1

[16] *Pension Benefits Act, SNB 1987, c P-5.1*, s 100.5(1).

[17] Subsection 100.5(4) of the New Brunswick *Pension Benefits Act* provides that "a trustee shall act independently of the person who appointed him or her."

employer plan sponsors that there generally is a reluctance to move plan administration to a joint governance model. Perhaps the requirement to include a certain number of independent trustees on a jointly governed board would help to make single employer plan sponsors more comfortable with this type of governance model.

In our view, there is an argument to be made for greater use of joint governance – in particular for defined contribution and target benefit pension plans, where members bear some or all of the risk. Joint governance can help bring different perspectives to plan administration and governance, including member and potentially retiree perspectives. However, recognizing that it can be a more expensive administration model to maintain, joint governance should not be mandatory for all pension plans. For example, smaller pension plans may be better suited to other models of administration. We are also of the view that there is a strong case to be made for qualified independent trustees on any pension boards of trustees. Independent trustees, who have pension expertise, can assist boards of trustees in fulfilling their fiduciary obligations.

MANAGING CONFLICTING LEGAL DUTIES POST-INDALEX

Most private sector pension plans are still administered by the plan sponsor (the employer), as opposed to a board of trustees or other such body. With the employer in the dual role of sponsor and administrator, conflicting legal duties can arise. This is because a sponsor's role in relation to the pension plan and governance is non-fiduciary, whereas the administrator's role is fiduciary in nature. Prior case law developed regarding addressing these potentially conflicting roles - generally referred to as the "two hats" doctrine.[18] Although the application of the two hats doctrine can be clear in certain cases (for example, sponsors generally have the authority to develop plan design and make plan amendments), there are many instances where the role is murky. For example, in the context of a defined contribution pension plan, if the plan sponsor establishes the plan with unlimited investment options, can the administrator change the number of options?

The Supreme Court of Canada decision of *Sun Indalex Finance, LLC v. United Steelworkers* has arguably refined the two hats doctrine.[19] In this case, the court called into question the ongoing 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 obligation 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."

This case refined the two hats doctrine in our view. Essentially, the mere existence of a conflict under a dual

[18] This "two hats" doctrine was developed from case law to provide a framework for managing potential conflicts between sponsor role and administrator role. See *Imperial Oil Ltd v Ontario (Superintendent of Pensions)*, (1995), 18 CCPB 198.

[19] *Sun Indalex Finance, LLC, v United Steelworkers*, 2013 SCC 6, [2013] 1 SCR 271 at para 65.

role will not preclude an employer from exercising sponsor rights and powers it has outside its role as plan administrator. However, an employer cannot ignore steps it should then take within the scope of its authority as plan administrator to address identified conflicts to avoid any breach of its fiduciary duties. Accordingly, when an employer is acting, it must first identify whether it is a plan administrator or a plan sponsor function. If it is a plan sponsor function, the employer must take the further step of considering whether it triggers any plan administrator responsibility.

The Draft CAPSA Guideline No. 4 also addresses this issue. It provides:

> "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."

Accordingly, we know from the *Indalex* decision and CAPSA's guidelines that the administrator obligations trump in cases of conflict. In terms of moving forward and trying to manage potential legal conflicts, perhaps governance policies (which address potential conflicts of interest) should be more broadly required. Another alternative may be to require joint governance for administration. A jointly governed board of trustees will generally be in a better position to avoid or address sponsor/administrator conflicts.

CONCLUSIONS

Plan administrators, as fiduciaries, should strive for good pension governance. This would include implementing CAPSA's governance guidelines and looking at other best practices for governance. Administrators may wish to consider implementing governance policies, even where not required under the applicable legislation. The process of developing the governance policy will undoubtedly require the administrator to take a close look at its current practices and assess what changes should be made, if any. Also, an outside set of eyes on governance practices may be advisable. As discussed above, in some jurisdictions this type of assessment is regularly required. In our view, governance audits or reviews should be regularly undertaken to review compliance, best practices and areas for potential improvement.

As we discuss in this paper, there is an increased focus on governance and on the regulation of governance. CAPSA has been regularly issuing and updating various policies. Further, we have seen increased pension legislation and regulation targeting governance practices.

We also discuss the joint governance model as a potential alternative to the traditional single employer plan administrator/sponsor model. As we discuss, a joint governance structure may be one way to help avoid conflicts that frequently arise where the employer is acting as both sponsor and administrator.