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CAPSA Consultation: Prudence Standard and the Roles of Plan Sponsor and Administrator in Pension Plan Funding and Investment

**NATIONAL PENSIONS AND BENEFITS LAW SECTION
CANADIAN BAR ASSOCIATION**

April 2010

PREFACE

The Canadian Bar Association is a national association representing 37,000 jurists, including lawyers, notaries, law teachers and students across Canada. The Association's primary objectives include improvement in the law and in the administration of justice.

This submission was prepared by the National Pensions and Benefits Law Section of the Canadian Bar Association, with assistance from the Legislation and Law Reform Directorate at the National Office. The submission has been reviewed by the Legislation and Law Reform Committee and approved as a public statement of the National Pensions and Benefits Law Section of the Canadian Bar Association.

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I. INTRODUCTION

The Canadian Bar Association National Pensions and Benefits Law Section (the CBA Section) is pleased to respond to the Canadian Association of Pension Supervisory Authorities (CAPSA) consultation paper on the Prudence Standard and the Roles of the Plan Sponsor and Plan Administrator in Pension Plan Funding and Investment (the paper). The CBA Section comprises lawyers from across Canada who practice in the pensions and benefits area of law.

II. GENERAL COMMENTS

A. Prudence Standard

The application of the “prudent person” rule to pension plan investment is not new. However, the contours of this rule as it applies to pension plans have not always been clear. Pension plan administrators have been concerned that the “traditional fiduciary standard” could be applied to them without consideration of the particular nature of pension plans and the environment in which they operate. Courts are increasingly taking into consideration the special characteristics of pension plans when determining issues related to pension plans.¹

The CBA Section would welcome guidelines on best practices for pension plan investment to clarify the fiduciary standard that pension plan administrators are measured against. Any guidelines should not unduly increase the administrative burden on pension plan administrators and should take the size of the pension plan into account.

¹ See, for example *Buschau v. Rogers Communications Inc.*, [2006] 1 S.C.R. 973.

B. Dual Role of the Employer/Plan Sponsor

For many years, employers have struggled with their dual role as both employer/sponsor and plan administrator. The CBA Section supports clear recognition of the differences between the two roles, which would be consistent with recent court decisions.² The paper sometimes uses "sponsor" and "administrator" interchangeably where there should be a distinction. For example, funding is a sponsor function, so it is a sponsor's role to develop a funding policy (see "Developing a Funding Policy" on page 14). This sponsor function is obscured by language like "plan administrators ... should be encouraged to have funding ... policies ..." (see "Applying the Prudent Person Role" on page 9). The CBA Section recommends that the roles, as outlined, be consistently differentiated throughout the paper.

C. Funding Policy

We understand that the new funding policy indicates which decisions would rest with the employer, while decisions that would rest with the plan administrator would be set out in the Statement of Investment Policies and Procedures (the SIP&P). From a fiduciary standpoint, this may solve some dilemmas faced by plan administrators when making decisions relating to funding, such as the selection of actuarial methods and assumptions. As the funding of pension plans is an area where the interests of the employer and the plan members are likely to conflict, assigning responsibility for the funding policy to the employer is helpful.

The funding policy should address the "utilization of funding excess", which appears to be an important element of the funding policy. We question whether effective funding policies can be developed until the uncertainty relating to funding excess or surplus issues is lifted.

D. Harmonization and Clarity

In several places the paper indicates a desire for consistency between the funding policy and the investment policy. The funding policy should be clearly a plan sponsor function while the investment policy is clearly a plan administrator function. We agree that funding and investment policy should, at least in theory, take into account the plan sponsor's and the plan administrator's goals and objectives, but each one proceeds from a different point. The plan

² *Lloyd v. Imperial Oil Limited* (2008), 93 Alta. L.R. (4th) 321.

administrator has a fiduciary obligation and the plan sponsor does not. This should be clearly stated in the paper.

In some aspects the paper is inconsistent with legislation in many provinces. We encourage harmonization between provincial legislation and the guidelines, so plan sponsors and administrators can be clear on what standards they should follow. If the paper is intended to simply clarify the regulators' views on the division of responsibility in a pension plan, this should be stated explicitly.

III. SPECIFIC QUESTIONS

Q1: What role should the plan administrator play regarding the funding policy?

The CBA Section supports CAPSA's recommendation that all plan sponsors create and periodically review a funding policy for their pension plans. For single employer pension plans, we agree that creating and reviewing the funding policy is a plan sponsor function, while the investment policy is an administrator function. However, there may be specific circumstances where it is appropriate and even necessary for the administrator to be involved in creating the funding policy. These circumstances would generally be limited to plans where the same body acts as sponsor and administrator, and multi-employer pension plans.

As to the role the plan administrator should play regarding the funding policy, the CBA Section recommends that for single employer pension plans the administrator's role be limited to the functions set out below. However, for jointly governed pension plans, the administrator's role will incorporate the following functions, but also may be broader, as suggested above.

- The CBA Section recommends that best practices guidelines established by CAPSA require plan sponsors to provide the plan administrator with a copy of the completed funding policy. Plan administrators should be expected to review the funding policy and the investment policy to ensure the two documents are consistent. Where there are inconsistencies between the documents, the CBA Section supports CAPSA's recommendation that the plan administrator be responsible for amending the investment policy to ensure consistency.
- The CBA Section also supports best practices guidelines that would require the plan administrator to be responsible for communicating the funding policy to plan members, beneficiaries and other stakeholders, in line with the plan's existing communication policies.
- Similarly, in accordance with the CAPSA Guideline No. 4: Pension Plan Governance Guideline and Self-Assessment Questionnaire, if the plan sponsor has adopted a funding policy, the governance documents should

indicate the administrator's responsibility to ensure consistency between that funding policy and the SIP&P, and to communicate the policy to the members of the plan.

Beyond these functions, the CBA Section recommends that a plan administrator have no role with respect to the funding policy, reflecting that the funding policy is a function of the plan sponsor.

Q2: Are the elements for the funding policy set out in this paper sufficient? If not are there some additional elements you would recommend?

The CBA Section believes that the eleven proposed elements for a funding policy are generally appropriate and sufficient. The CBA Section does not recommend that any elements be added to CAPSA's best practices guideline on funding policies at this time.

Under Element #1, *Funding Objectives*, the CBA Section questions the language proposing that a funding policy's funding objectives "integrate with the plan's SIP&P". As indicated in our response to Question #1, the establishment of a funding policy for single employer plans is a matter for the plan sponsor. Rather than recommending that a plan's funding policy and SIP&P be "integrated", which suggests that the funding policy could depend on the contents of the SIP&P, the CBA Section recommends that CAPSA's best practices guidelines indicate that if a funding policy and SIP&P are inconsistent, the administrator should adapt the SIP&P to be consistent with the objectives set out by the sponsor in the funding policy.

Under Element #2, *Key Risks Faced by the Plan*, a funding policy should not require a sponsor to describe risks that would reveal a sponsor's confidential business, financial circumstances or strategy. We recommend that CAPSA revise Element #2 accordingly.

Under Element #6, *Utilization of Funding Excess*, CAPSA should identify that a sponsor's policy on funding excess (for example, surplus and contribution holidays) could, as with many other elements of the funding policy, be affected by the wording of the pension plan text. In this regard, CAPSA should emphasize that provisions in the funding policy cannot substitute for entitlements either set out or not set out in the plan text. Alternatively, CAPSA could choose to preface the guidelines by stating that the elements of a funding policy will be subject to the terms of the plan text, other agreements (if applicable) and legislation.

Under Element #10, *Monitoring*, we believe that CAPSA should recommend that the funding policy identify specific circumstances or events triggering a review and possible revision of the policy. Such circumstances could include changes in the financial risks of the plan sponsor or plan demographics.

Finally, as with previous CAPSA guidelines, CAPSA should emphasize that the eleven elements of a funding policy represent best practices only. A comprehensive funding policy addressing all eleven elements may be appropriate for sophisticated plans, but might be overwhelming for smaller plans. CAPSA's best practices guidelines should therefore indicate that sponsors and administrators (to the extent that they are involved with the development of a funding policy in plans other than single employer pension plans) may satisfy their obligations without having a funding policy that addresses all eleven elements that may apply.

Q3: What role should the plan sponsor play regarding the SIP&P?

The funding policy and the SIP&P are each affected by the other:

- The administrator is responsible for the SIP&P but the sponsor is directly affected by the SIP&P where the sponsor is ultimately responsible for funding the plan – i.e. in any single employer plan. The investment return assumptions in the actuarial valuation report must be reasonable in light of the asset mix chosen by the administrator, so a more conservative approach to investments in the SIP&P will increase the cost of funding the plan for the sponsor and *vice versa*.
- The funding policy adopted by the sponsor will also have an impact on the SIP&P.

The administrator is ultimately responsible for the SIP&P, so while the sponsor may provide comments to the administrator regarding the SIP&P, the administrator is not obliged to take them into account. Given the inter-related nature of these policies, it would be beneficial for each party to communicate with the other when considering changes to the policy it controls. The sponsor can advise the administrator of the content of the funding policy so that the administrator can weigh that in developing the SIP&P.

The extent of the involvement and discussion between the plan sponsor and the plan administrator will vary with the type and size of plan. For larger, more complex plans, a greater degree of integration and consultation will be required than for smaller, employer sponsored and administered plans.

Q4: Under what circumstances should the plan administrator be encouraged to have an investment policy covered by more than one document?

We agree with the recommendation to adopt an overall investment policy broader in scope than the mandatory SIP&P to deal with matters relating to pension fund investment (including those enumerated under "Investment Policy" on page 20 of the Consultation Paper), in addition to the components prescribed for a SIP&P. However, the focus should be to stress that such matters be documented, not whether they should be contained in one or more documents.

Instead of encouraging or discouraging a plan administrator to have an investment policy covered by more than one document, plan administrators should be encouraged to document recommended additional matters relating to the investment of the pension fund as part of a good governance practice, and leave it to plan administrators to determine the number of documents required for the investment policy. Sometimes it may be desirable to adopt more than one document to cover the elements of a SIP&P and an investment policy. For example, where a pension plan has both a defined contribution component and a defined benefit component the funding issues are different than for a straight defined benefit plan, and pension fund investment is closely linked to pension plan funding. Another situation is where the investment structure of a pension fund is complex.

Q5: Does this paper adequately address what additional elements could be incorporated into the SIP&P?

We agree that a SIP&P should address all of the elements that are prescribed in the Federal Investment Rules (the "FIR"). We further agree that the SIP&P needs to be dynamic to address changing market conditions and regulatory environments and to allow flexibility for plan administrators. Coordinating the funding and investment policy documents accompanying the SIP&P will be crucial to maintain a stable environment for plan members, sponsors and administrators. Similarly, transparency, disclosure and guidance concerning investment management and monitoring are beneficial for all pension stakeholders.

There is no legal impediment to expanding a SIP&P to deal with the matters CAPSA recommends to be included in an investment policy. The list of mandatory components for a SIP&P, as prescribed by the pension legislation, is inclusive and does not require a SIP&P to deal with only the enumerated mandatory components. Our experience is that it is quite common for a SIP&P to include additional information (such as information relating to

investment philosophy and the roles of different players involved in the investment of a pension fund) other than only the information prescribed.

Q6: Are the items listed in the section Regulator Examinations and Review of Funding and Investment Processes sufficient? If not, what additional elements do you recommend?

One significant element missing from the Regulator Examinations and Review of Funding and Investment Processes (Regulator Examinations) relates to statutory compliance. In addition to the prudence standard, plan administrators are under a statutory obligation to ensure the assets of a pension plan comply with applicable restrictions in terms of, for instance, quantitative limits regarding asset allocation, restrictions on ownership of certain types of investments, or limits on the percentage interest a pension fund can have in a given investment. Recent jurisprudence³ has highlighted the importance of plan administrator oversight of compliance issues related to quantitative limits applicable to pension assets, and the need to maintain appropriate compliance verification processes. Accordingly, the following should be added to the Regulator Examinations:

- ***Determines whether the administrator has created and implemented a system for ensuring that the fund's investments, including asset allocation, is compliant with applicable regulatory limits.***

IV. CONCLUSION

The CBA National Pensions and Benefits Law Section trusts that our comments will assist CAPSA in its work. We would be pleased to provide further information on the points addressed in this submission or otherwise in connection with the consultation.

³ See *R. v. Christophe et al*, 2009 ONCJ 586 (CanLII).