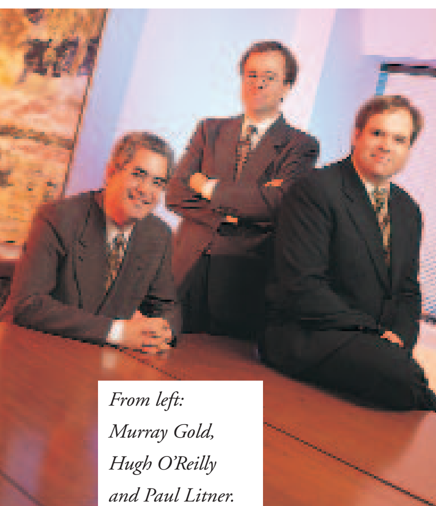
Reform by osmosis

The Sarbanes-Oxley Act in the U.S. and its corporate governance reforms are beginning to affect Canada. Are more pension plan changes on the way?

By Paul Litner

THE SARBANES-OXLEY ACT (SARBANES) OF 2002 WAS THE U.S. legislative response to the financial scandals that plagued such corporate giants as Enron and Worldcom. It was designed to restore public confidence in the capital markets, primarily by enhancing rules for corporate governance.



From left: Murray Gold, Hugh O'Reilly and Paul Litner.

Sarbanes imposed investor protection measures such as: enhanced financial disclosure; certification of financial statements by management; tougher penalties for non-compliance; auditor independence requirements; increased responsibilities for audit committees and a stipulation they be independent from management and restrictions on securities trades by officers and directors during pension blackout periods.

Following its enactment last year, American securities regulators and stock exchanges have been drafting detailed regulations to give life to the directives contained in Sarbanes, which has now become a watershed for major corporate governance reforms in the U.S. Like many other major U.S. legal initiatives, Sarbanes is starting to spill over the border and is beginning to affect the areas of securities regulation and corporate governance in Canada.

For instance, Canadian securities regulators have released for comment draft rules which, if enacted, would govern chief executive officer and chief financial officer certifications of financial statements and the roles and composition of audit committees.

Perhaps the most notable development in Canada has been this year's passage of Ontario's Bill 198, which expands the rights of investors to sue public corporations and their directors and officers for misrepresentations. The Bill 198 reforms, once proclaimed in force, will usher in a new regime of civil liability for secondary market disclosure in Canada. They are likely to breathe new life into shareholder activism, with pension funds leading the charge.

INVESTOR PROTECTION

So what are the implications of Sarbanes for pension plans in Canada? As investors, Canadian plans will benefit from the added investor protection measures already in place in the U.S. and any similar measures ultimately adopted in Canada.

In the U.S., the only pension-specific legislative amendments resulting from Sarbanes were those requiring advance notice to plan members of pension blackout periods and restricting securities trades by officers and directors during such periods. Canada has seen no such reforms to date.

However, given the impact that corporate governance has had on the development of pension plan governance principles, it is possible that reforms initiated by Sarbanes will lead to future changes to Canadian plan governance practices.

For example, Sarbanes contained enhanced requirements regarding the independence of auditors and audit committees. U.S. regulators responded by requiring that audit committees be composed of independent directors and requiring that auditors meet stringent tests for independence.

One wonders whether such independence requirements will filter into the pension arena; will actuarial firms have independence requirements imposed on them like auditors? Will the dual role played by many employers as both plan sponsor and plan administrator be called into question? Quebec dealt with this years ago by mandating that pension plans be administered by pension committees composed of representatives of the employer and plan members. To date, no other jurisdictions have followed its lead.

The inherent conflict between the role of corporate employer—acting in the best interests of the shareholders—and the role of administrator—acting in the best interests of the plan members—is statutorily enshrined in Canada. But in view of the Sarbanes-led wave of corporate governance reforms, will this dual role be permitted to stand? **BC**

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