Good governance leads to better outcomes for a pension plan. That’s a given. If the party responsible for administering a plan builds a system, constructs a thoughtful process and incorporates risk management principles into the structure, then it’s highly likely that the outcomes for the plan will improve.

To a large degree, governance is about process, consistent management and making the right decisions. Pension committee members build a system and follow a process to demonstrate that they have engaged in due diligence that will also help protect committee members from liability. But does it also lead to positive results in the operation of the pension plan? Well, yes.

If the committee pays proper attention to the governance process, then the typical outcome is better results in the operation of the plan. One tenet of good governance is that the plan administrator should follow a considered and thoughtful process. This helps not only to protect those involved by demonstrating due diligence but also to ensure that the committee considers all relevant factors and, therefore, reaches a better-informed conclusion.

Building a Process
So what should a pension plan administrator consider when creating an appropriate governance structure and process?

First off, some administrators may question whether or not it’s necessary or even prudent to establish a committee that will be central to the entire structure and process—individual employees, they may say, can gather around a table informally and do the same thing. (In Quebec and Manitoba, a pension committee is mandated to be the official administrator of the plan. In other jurisdictions, there is no such requirement, except in the case of a multi-employer plan or other form of jointly governed plan.)
While that may be a valid point, consider this. Are those individual employees who are making these collective decisions without a formal mandate acting within the scope of their duties? Will each of them be shielded from criticism, and will their employer (the plan administrator) protect them from liability?

Having a committee appointed to make collective decisions with members who represent various disciplines and facets of the business can be far more effective. And, a formally appointed and mandated committee should be (and is) more protected in making decisions where the scope of its duties has been explicitly documented.

In order to satisfy its duty of care, a pension committee must rely on available resources, such as the support of the administrator’s staff. If resources are limited, pension committee members should spend their efforts in the areas that have the greatest potential to deliver results or reduce risk. Take, for example, the area of operational risk. It makes sense for a committee to delegate operational responsibilities to those who have the skills and the time to handle them properly. Nowadays, some plan administrators consider delegation outside the business in areas that would have been considered novel five or six years ago, and the mix of internal and external resources continues to evolve.

For instance, smart management of a plan may mean outsourcing activities that would have been treated as a core function of an employer’s operation 10 years ago (e.g., employee call centre or oversight of investment managers).

But if limited resources aren’t an issue, how does a plan administrator determine the appropriate governance structure and processes from the range of possibilities? Most important, the structure and processes should reflect the plan administrator’s culture and philosophy. Governance, in other words, shouldn’t be approached with a one-size-fits-all mentality. Different organizations may have different levels of risk that they may be willing to assume. A risk-averse plan administrator, for example, would presumably want tighter controls put on its administration processes. But that doesn’t mean an administrator operating with a more relaxed environment for its staff would take plan governance and administration lightly—it may just choose a different position on the spectrum of possible governance models.

Process Versus Results

Overall, the purpose of a governance structure and process is twofold: to protect the plan administrator (and agents, such as the pension committee members) and to generate better results in the operation of the plan.

It would not be unusual for a newly created committee, working through the process of establishing and documenting a governance system and preparing policies and checklists, to discover that it was handling some tasks well (although not documenting them) and completely overlooking others. The discipline of thinking through and documenting the actions and decision points that are involved in administering a pension plan can be beneficial in building the best operating process. The process itself encourages sound decisions by ensuring that the committee considers all the relevant factors and is not distracted by unimportant ones.

Of course, this positive effect is more likely to occur if the committee is devoted to making governance work and less likely if the committee is just going through the motions to simply put something on paper without actually following it.

The Indalex Decision

Although good governance generates better results and increases the likelihood of reaching the right answer, it does not guarantee the right outcome in all instances. Consider the facts in the recent Indalex case (see “Indalex: Know where to hang your hat” on BenefitsCanada.com) and whether good governance would have changed the outcome in that case. Governance due process incorporates risk management, which would operate to
identify significant conflicts of interest such as those that arose in Indalex. However, even the most rigorous screening for conflict of interest may not help if the legal or regulatory environment changes.

A plan administrator that applied the commonly accepted legal doctrine of the “two hats” in the facts of the Indalex case would not likely have foreseen the fiduciary breach that the Supreme Court of Canada identified in its decision. The two-hats doctrine assumes that a decision-maker can comfortably wear two hats: one as employer or plan sponsor and the other as plan administrator. Wearing two hats does not, in and of itself, create a conflict of interest. As long as the decision-making body can demonstrate that it is wearing only one hat at any particular point in time. This doctrine has provided a tool for employers that exercise both plan sponsor and plan administrator duties, enabling employers to determine if, and when, fiduciary standards apply to a particular decision or exercise of power.

The Indalex decision has effectively modified the two-hat doctrine, demonstrating that governance is an evolving practice. One of the Supreme Court justices writing the decision that formed part of the majority on the question of whether Indalex breached its fiduciary duty and when that breach occurred, pointed out that the nature of the decision (i.e., whether it is a plan sponsor or plan administrator function) is not as important as the consequence of the decision.

In the Indalex case, the action of an employer in financial difficulty arranging to borrow money for operations from a creditor under a super priority put that employer in a position of direct conflict with its duty to ensure that contributions were remitted solely on the basis to the employee’s underfunded pension plan. However, applying the two-hats doctrine, an employer could conclude that borrowing money and deciding where it is spent (i.e., to keep the business afloat) is a plan sponsor-employer decision that did not subject the employer to a fiduciary obligation to consider the impact on the pension plan. So an administrator in the Indalex scenario could have followed the proper governance procedure to the best of its ability, applied the commonly accepted legal test for conflict of interest and concluded that no conflict actually existed.

This demonstrates that it is possible to follow a considered process yet come out with a result, which, in hindsight, is judged to be incorrect. Even in a situation like this, however, the pension administrator should be able to earn “part marks” for the right process—even if the answer is incorrect. An effective governance process should operate to minimize the potential risks and minimize the impact. An effective governance system does not always work perfectly, but it is a good first step in the process.

While the Indalex case shows that a governance system does not always guarantee results—and it will need to evolve when internal or external factors have an impact—a system is still an effective tool for managing pension plans. The outcome in the Indalex case is not proof of a flawed governance system. It simply reflects the fact that the law regarding conflicts of interest took a turn that most people would not have predicted or foreseen. A good governance system can be self-regulating, and, following the Indalex decision, plan sponsors would expect that system to identify the need for any adjustments to reflect the outcome of the Indalex case.

The Blair Case

Another case (R. v. Blair, 1995) demonstrates the importance of ensuring that the governance process is constructed to lead to the intended result. In the Blair case, an employee invested pension assets in shares of the plan sponsor and exceeded a statutory limit on the value of assets that can be invested in one security. The investment committee established by the plan administrator was charged under the applicable pension legislation for failing to adequately supervise the activities of the employee. The Ontario Court of Justice concluded that the employee’s activities had not been monitored by the investment committee, but on reviewing the investment committee’s mandate, the court also determined that the committee’s mandate did not include responsibility for overseeing this employee. In that case, the board of directors of the employer, which was the administrator, would have remained responsible. The court found the investment committee not guilty, given the way that the changes were framed, but left the impression that the same people might have been guilty of an offence in their capacity as officers on directors. In typical circumstances, this responsibility for oversight would be expected to fall within the mandate of an investment committee, but, in this case, the process failed and the responsibility fell through the cracks.

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