

Measuring and Recording Pension and Benefit Plan Compliance – The Latest in Best Practices

Michael C.P. McCreary and A.G. Danna Morrison¹

There has been a growing trend in the field of pension plan governance to develop and adhere to a system of mechanisms in order to track compliance. This is particularly true with respect to third party service providers, including lawyers, consultants, accountants and others who provide services or advice to the plan administrator in order to provide assistance with the operation of a pension plan.² On November 21, 2008, Commissioner Harry Arthurs, along with key stakeholders, presented the Report of the Ontario Expert Commission on Pensions, entitled *A Fine Balance: Safe Pensions, Affordable Plans, Fair Rules*.³ This report made a number of recommendations, including a recommendation that the establishment of benchmarks or performance indicators would allow pension plans to evaluate their own practices by comparing them to those of plans across the system. The idea behind this is that the establishment of benchmarks would lead to greater transparency and, in turn, to greater plan performance.

This paper will examine a range of issues relating to measuring and recording compliance in pension and benefit plans. Due to the complexity of the topics being discussed, this paper is not intended to be an in depth evaluation of any of the topics, but rather a cursory discussion of compliance tracking. It will review, generally, how and why compliance is tracked. It will then examine the CAP Guidelines that have been created for Defined

¹ Of Watson Jacobs McCreary LLP, Toronto Ontario.

² Canadian Association of Pension Supervisory Authorities (“CAPSA”), *Guideline No. 4: Pension Plan Governance Guidelines and Self-Assessment Questionnaire*, (North York: CAPSA Secretariat, 2004) at 10.

³ Expert Commission on Pensions, *A Fine Balance: Safe Pensions, Affordable Plans and Fair Rules* (Toronto: Expert Commission on Pensions, 2008).

Contribution plans as well as the legislative requirements to be complied with by Defined Benefit plans. It will also provide suggestions for auditing plan personnel. The paper will close with a brief discussion on the benefits of utilising a compliance tracking system, particularly in avoiding and defending disputes. This paper will assert that by following best practices, plan sponsors and administrators can ensure that the plan is more transparent, that individuals working within the plan have defined and specific roles, and that if something should go wrong within the plan, there is documentation to support the claim that the plan's governing body has satisfied its due diligence and fiduciary duties to the plan beneficiaries.

Tracking Compliance

There has been a renewed interest in establishing and documenting roles and responsibilities for third party service providers. According to results from Towers Perrin's 2006 *Canadian Pension Challenges and Changes Survey*,⁴ plan administrators are taking a more involved approach to managing their plans. In fact, according to the survey, a main priority of survey respondents is the establishment of "clear, written documentation of governance roles and responsibilities or accountabilities,"⁵ for third party service providers. This shows that plan administrators have embraced the need for the adoption of a best practices-type compliance mechanism to aid in the tracking of compliance of service providers.

⁴ Towers Perrins, *Emerging Trends and Directions in Pension Governance* (Canada: Towers Perrins, 2007).

⁵ *Ibid.* at 4.

The Office of the Superintendent of Financial Institutions Canada (OSFI) and the Pension Investment Association of Canada (PIAC) have both played key roles in ensuring that the “high standards of pension fund governance and guidelines in Canada has been brought to the forefront.”⁶ The guidelines these institutions have created describe best practices for the governance of pension plans as well as the responsibilities of plan administrators.

Best practices, as outlined by these institutions, include⁷:

1. Clearly stated objectives;
2. Independence of the governing body from the plan sponsor;
3. Separation of governance from administrative operations;
4. Clearly defined roles, responsibilities, policies, fiduciary duties, and reporting requirements of all parties;
5. An understanding that tasks may be delegated, but not responsibilities;
6. Ensuring pension committee effectiveness;
7. Accountability, internal controls, performance measurement and reporting;
8. Risk identification and mitigation;
9. Adequate knowledge and skill sets;
10. Due diligence in decisions and the supervision of delegated work;
11. Controls for expenses and protection from conflicts of interest;
12. A code of ethics;
13. Transparency and full disclosure; and
14. A process of governance self-assessment.

In addition, Benefits Canada, an industry organization, has stressed the importance of creating defined differentiated roles for the plan sponsor, administrator, delegates, agents, advisors and members.⁸ It has also provided a list of emerging best practices, including:⁹

1. Adopting clear criteria for the selection and appointment of committee members with the right expertise;
2. Strengthening reporting channels between the committee and other parties;
3. Establishing a code of conduct and conflict of interest policy for committee members; and

⁶ WCM, “Identification of “Best Practices” for the Governance and Administration of Pension Plans” *Best practices identification as at April 2006*, online <<http://www.uwindsor.ca/>> at 1 (accessed October 14, 2009).

⁷ *Ibid.* at 1.

⁸ Ian Genno and Mark Campbell, “Call to Order,” (August 1, 2009), online: Benefits Canada <www.benefitscanada.com/pensions> at 1.

⁹ *Ibid.* at 2.

4. In multinational companies, instituting global oversight of plan and codifying global pension governance guidelines and committee objectives.

In order to ensure that the best practices outlined above are adhered to, a system of processes and criteria must be established by the plan's governing body and followed by the governing body as well as any additional service providers. This will allow the administrator to assess the plan's governance on a regular basis and to ensure that these practices are being followed, ensuring that the plan is run in such a way as to provide greater transparency and performance.

While recognizing that blind adherence to best practices could lead to a “de facto lemming standard”,¹⁰ Keith L. Johnson and Frank Jan de Graaf did make a recommendation that in order to modernize pension fund governance practices, it may be appropriate to “convene a market-specific best practices commission” that would allow for a “‘comply or explain’ reporting approach on compliance with best practices.”¹¹ This would allow for best practices to be followed where it would be prudent to do so, but would also allow for flexibility where needed. Such a flexible approach would be of the utmost benefit to pension plan administrators. While the best practices are to be followed generally, it is not difficult to imagine a situation in which innovative thinking may be of benefit to the plan. In those cases, the administrator should not be shackled to best practices, but should remain accountable to explain why in that particular case it has veered away from the established industry norms.

¹⁰ Keith L. Johnson and Frank Jan de Graaf, “Modernizing Pension Fund Legal Standards for the Twenty-First Century” (2009) 2:1 *Rotman International Journal of Pension Management* 44 at 45.

¹¹ *Ibid.* at 48.

It is common for pension plan administrators to delegate tasks related to the running of the plan to third party service providers. In fact, in many situations, it makes prudent business sense to hire individuals with specialized expertise areas to provide assistance to the plan. However, because the governing body of the plan has a fiduciary duty to its beneficiaries, it is important to ensure that any third party service provider is both knowledgeable and willing to accept the responsibilities of such a fiduciary duty.¹² The pension governance structure should provide a description of the duties, responsibilities and reporting requirements of any and all third party service providers based on generally agreed upon best practices in order to ensure that these service providers are acting in accordance with the best practices of their respective fields.

There is no one mechanism used to track compliance with listed expectations. In fact, there is not even one single list of agreed upon expectations. Currently, it is up to the plan's governing body to confer and develop a list of expectations and then to further develop a mechanism with which to track the plan's compliance with said expectations. These expectations should be modelled on industry norms in order to establish that the individual is acting as a reasonable and prudent individual would, in order to satisfy its fiduciary duty. As will be discussed further below, what is important is that the mechanism selected to track compliance within a plan is uniformly applied over time. This will allow the governing body to see what aspects of the plan, and the plan's personnel, are performing at the expected level, and what needs to be addressed in order to bring inadequate performance up to the expected levels.

¹² WCM, *supra* note 5 at 2.

What happens if you don't track compliance?

If a plan's governing body chooses not to track compliance, it puts itself in the precarious position of not fully knowing what each and every service provider is doing and whether the service providers are attaining the level of service that is expected of them. Particularly where the governing body has chosen to delegate tasks to external parties, it is difficult to track whether these parties are acting in accordance with the plan's governance.

Further, without a clear and established differentiation of roles and responsibilities of each involved party, the plan runs a risk of some work being duplicated while other work falls to the wayside. By creating a system of tracking whom is responsible for which tasks, the plan can address this costly problem. In addition, creating clear guidelines for roles and responsibilities will also unequivocally establish who owes a fiduciary duty to the beneficiaries. This will ensure that should a problem arise in the future, the appropriate parties will be held responsible for their actions, or lack thereof.

Defined Contribution (CAP Guidelines) Compliance

On May 24, 2004, the Joint Forum of Financial Market Regulators released their final version of the *Guidelines for Capital Accumulation Plans* ("CAP Guidelines"). These have since been approved by the Canadian Association of Pension Supervisory Authorities ("CAPSA"), the Canadian Council of Insurance Regulators, and the Canadian Securities Administrators. CAPSA has adopted the CAP Guidelines as *CAPSA Guideline*

*No. 3, Guidelines for Capital Accumulation Plans.*¹³ While the Guidelines are voluntary, at the time of their adoption, it was the stated expectation of CAPSA that pension plans with CAP components would be operated in accordance with the CAP Guidelines as of December 31, 2005. The Guidelines were developed in order to provide an outline of the “roles and responsibilities of sponsors, service providers, and members in the operation of these plans and provide guidance on the information and assistance that should be provided to plan members to assist them in making investment decisions.”¹⁴ The Guidelines are as follows:

1. Fiduciary responsibility;
2. Governance objectives;
3. Roles and responsibilities;
4. Performance measures;
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; and
11. Governance review.

Under these Guidelines, the plan administrator is permitted to delegate certain tasks to other individuals, but ultimately, is responsible for the actions of delegates. Further, the Guidelines provide the suggestion that, “roles and responsibilities, accountability and reporting relationships are clearly documented and communicated to all participants in the pension plan governing process.”¹⁵ In addition, the plan administrator should establish procedures to ensure that performance measure standards are met and that there are procedures in place to follow up on any actions which are found to be inadequate.

¹³ CAPSA, *Guideline No. 3: Guidelines for Capital Accumulation Plans* (North York: CAPSA Secretariat, 2004).

¹⁴ CAPSA, *Guideline No. 4*, *supra* note 1 at 4.

¹⁵ *Ibid.* at 7.

Principle 8 of the Guidelines directs that there should be an established set of mechanisms that “oversee and ensure compliance with the legislative requirements and pension plan documents and administrative policies.”¹⁶ Creating such a set of mechanisms will allow the plan’s governing body to ensure that administrative functions fall within the plan’s terms, the plan’s administrative policies as well as any legislative requirements.

Finally, a prudent plan administrator should regularly conduct a review of its plan governance. In so doing, the administrator will be able to establish whether required fiduciary duties and other responsibilities are being met, not only by the administrator, but also by other parties working for the plan. Naturally, any self-assessment procedure will be tailored to the individual circumstances of each plan, but a model questionnaire was created by CAPSA and included in its *Guideline No. 4: Pension Plan Governance Guidelines and Self-Assessment Questionnaire*.¹⁷

Legislative Compliance for Defined Benefit Plans

Defined Benefit plans are heavily regulated. The Canadian Revenue Agency ensures that they comply with all applicable tax rules. In addition, pension regulators oversee Defined Benefit plans. Federal pension regulators oversee plans for “federal employees, people in the northern territories and those in certain industries such as banking, transportation and

¹⁶ *Ibid.* at 8.

¹⁷ *Ibid.* at 11-15.

telecommunications”,¹⁸ whereas provincial regulators oversee the rest of the pension plans.

This paper will examine the legislative rules pertaining to Ontario pension plans, which are covered by the *Pension Benefits Act*.¹⁹ The *Pension Benefits Act* applies to every person that is employed in Ontario.²⁰ This legislation prohibits any person from administering a pension plan in Ontario before a certificate of registration or an acknowledgement for registration of the pension plan has been issued by the Superintendent.²¹ Under s. 20 of the *PBA*, the administrator must file an annual information return each year in respect of the pension plan, as well as additional reports if and when prescribed by the relevant regulations.

The administrator of an Ontario Defined Benefit plan has a fiduciary duty to its plan’s beneficiaries. Specifically, he or she is required to “exercise the care, diligence and skill in the administration and investment of the pension fund that a person of ordinary prudence would exercise in dealing with the property of another person.”²² In addition, the administrator will be required to use any additional special knowledge or skills that a person in the “administrator’s profession, business or calling, ought to possess.”²³ This means that it is very likely that the administrator will actually be held to a higher standard of care than that of an ordinary person.

¹⁸ Bruce Cohen & Brian Fitzgerald, *The Pension Puzzle: Your Guide to Government Benefits, RRSPs and Employer Plans*, 3 ed., (Mississauga: John Wiley & Sons Canada, Ltd., 2007) at 63.

¹⁹ *Pension Benefits Act*, R.S.O. 1990, c. P.8 [“*PBA*”].

²⁰ *PBA*, *ibid.*, s.3.

²¹ *PBA*, *ibid.*, s. 6.

²² *PBA*, *ibid.* s. 22(1).

²³ *PBA*, *ibid.* s. 22(2).

Like in the Defined Contribution plans discussed above, an administrator of a Defined Benefit plan may employ agents in order to carry out “any act required to be done in the administration of the pension plan and in the administration and investment of the pension fund”²⁴ and these agents are subject to the same standards that apply to the administrator.²⁵ The administrator, however, is required to be satisfied that the agent is suitable for the selected task and the administrator must supervise the agent as is prudent and reasonable.²⁶

Under the *Pensions Benefit Act*, members and former members of the plan, by majority, can establish an advisory committee which can, among other things, monitor the administration of the pension plan.²⁷ The administrator is required to provide information to such a committee in order to assist it in achieving its stated purpose. The monitoring purpose of an advisory committee can be akin to that suggested by the CAP Guidelines, though it need not be. In addition, the administrator is required to provide a written statement to each member annually containing the prescribed information in respect of the pension plan, the member’s benefits and any ancillary benefits.²⁸

Tracking legislative compliance of Defined Benefit plans is arguably easier than tracking compliance of Defined Contribution plans. The reason for this is, simply, that the compliance requirements for Defined Benefit plans are not transitory, voluntary, or

²⁴ *PBA*, *ibid.* s. 22(5).

²⁵ *PBA*, *ibid.* s. 22(8)

²⁶ *PBA*, *ibid.* s. 22(9).

²⁷ *PBA*, *ibid.*, ss. 24(1) and 24(4)(a).

²⁸ *PBA*, *ibid.* s. 27.

developed on a plan-by-plan basis. Further, there are regulators whose responsibility it is to ensure that compliance with the appropriate legislation is maintained by Defined Benefit plans. As such, tracking compliance of Defined Benefit plans does not provide the same difficulties as tracking compliance of Defined Contribution plans.

Auditing the Individuals Involved in Your Plan

Regular performance monitoring is an important responsibility of any pension plan's governing body. This does not only encompass auditing the performance of the plan itself (which is a topic of its own, and will not be discussed in this paper), but also encompasses auditing the performance of all the parties who are involved in the operation of the plan. Benefits Canada suggests that the governing body "establish clear criteria for hiring, monitoring and replacing all plan fiduciaries and service providers, both internal and external, and should conduct regular and meaningful reviews based on these criteria."²⁹ It is important that these criteria are easily accessible and clearly reported to any parties who may be affected by them. This will ensure that everyone, and not just the governing body, is aware of what the benchmarks are, thereby making it more likely that said benchmarks will be met. This will also help to track performance by making individuals more accountable for their work, and if a problem arises, it will be much easier for the governing body to identify where the problem lies and what needs to be accomplished in order to reach an appropriate solution.

Creating formal guidelines is only one half of the important puzzle of auditing the parties working for a plan. In addition to tracking compliance through guidelines, it is vitally

²⁹ Genno and Campbell, *supra* note 7 at 3.

important that the plan's governing body develop a practice of creating clear and extensive documentation of not only the established guidelines, but also of where the guidelines have been met and where fiduciaries and service providers have fallen short. Further, a detailed reporting system will be beneficial in establishing that the plan has satisfied its due diligence, should the plan be faced with an audit or impending litigation.

Benefits of a Compliance Tracking System: Avoiding and Defending Disputes

There are a number of benefits to having a compliance tracking system in place. Perhaps the most important benefit is that it allows for the plan's governing body to create a method of self-assessment to monitor the parties working for the plan. By so doing, the governing body can become acutely aware of who is performing which tasks and whether the tasks are being performed in accordance with agreed upon best practices and to the level expected by the governing body.

In recent times, there has been an increase in the number of class action lawsuits against plan administrators and related individuals as a result of deficient plan governance. It is expected that with the continuance of these types of litigation in the future, the CAPSA self-assessment principles for good governance, discussed above, will become part of the fiduciary standard of practice to which the courts will hold plan sponsors, administrators and third party service providers. Courts will likely compare the processes utilized and decisions made by a plan's governing body to those of industry norms in attempting to establish whether or not the fiduciary test of prudence has been satisfied. As such, adhering to established guidelines will be beneficial in arguing that the party in question

has acted as a reasonable and prudent individual would have done and therefore has not violated any fiduciary duty required of it.

In addition, a well-documented system of governance will be beneficial in any future litigation as a means to establish that, in fact, the fiduciary duty owed has been satisfied. In essence, by ensuring that the system of governance accurately and in detail describes the steps taken and benchmarks created in order to track compliance, the plan's governing body can strengthen its "due diligence" defence to be used against any legal claims of improper action.

Therefore, while in the immediate short term, establishing a detailed system to track and report compliance may seem like a costly and work-intensive endeavour, the future benefits will certainly outweigh any present costs. In addition, the initial start up of creating such a system would not need to be repeated on a yearly basis. Once the system is in place, it will only need minimal changes in order to ensure that it is operating as it should to provide a reliable and accurate tracking and documentation mechanism for those that undertake to act on behalf of, or for, the pension plan.

Conclusion

To conclude, establishing clear guidelines as to roles and responsibilities of the parties working for a plan as well as creating and following procedures to ensure that these guidelines are being met is a very important task for a plan's governing body. It is through the creation and adherence to a compliance tracking system that the governing

body will be able to spot potential problems before they arise. Further, should a problem lead to litigation, by following an established set of best practices, it will be far easier for the party in question to establish a due diligence defence. Completing a regular self-assessment on an annual basis will allow the governing body to ensure that those parties to which it has delegated tasks are satisfying their fiduciary duties to the plan's beneficiaries. In short, the additional work required to set up a series of mechanisms for establishing and tracking compliance is more than made up for by the future benefits it creates.