

November 30, 2009

Dear Pension Industry Stakeholder:

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

On behalf of the Canadian Association of Pension Supervisory Authorities (CAPSA), we are pleased to release the enclosed consultation paper on the *Prudence Standard and the Roles of the Plan Sponsor and Plan Administrator in Pension Plan Funding and Investment* for your review and comment.

CAPSA believes that good pension plan governance in terms of best practices in pension plan funding and investment is essential if plan members are to receive the benefits they have been promised. Building on CAPSA *Guideline No. 4: Pension Plan Governance Guidelines and Self-Assessment Questionnaire* the consultation paper has been prepared to provide guidance to pension plans of all types and sizes, in all jurisdictions of Canada, in their funding and investment activities.

This consultation paper is part of CAPSA's strategic initiative to promote consistency in the governance of pension funds and funding. CAPSA has pursued this priority by:

- Examining the issues surrounding the application of the prudent person rule, giving consideration to both the assets and liabilities of pension plans
- Developing a common approach to funding policies, recognizing the link to fund governance.

In particular, CAPSA would appreciate your comments on the following questions:

1. What role should the plan administrator play regarding the funding policy?
2. Are the elements for the funding policy set out in this paper sufficient? If not are there some additional elements you would recommend?
3. What role should the plan sponsor play regarding the Statement of Investment Policy and Procedure (SIP&P)?
4. Under what circumstances should the plan administrator be encouraged to have an investment policy covered by more than one document?
5. Does the paper adequately address what additional elements could be incorporated into the SIP&P?

6. Are the items listed in the Regulator Examinations and Review of Funding and Investment Processes section sufficient? If not what additional elements would you recommend?

Please forward your written comments on the CAPSA consultation paper on the *Prudence Standard and the Roles of the Plan Sponsor and Plan Administrator in Pension Plan Funding and Investment* to:

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We look forward to receiving your comments by January 29, 2010. Questions arising from this consultation paper may be directed to any of the members of the CAPSA Prudent Funding and Investment Committee identified in Appendix B.

Please note that this consultation paper has been prepared to contribute to the adoption of good pension plan funding and investment practices in all Canadian jurisdictions. They do not reflect the official position of any provincial or federal government or agency.

Yours very truly,

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Chair, CAPSA
Actuaire Principal
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Dave Gordon
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Appendix B

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**The Prudence Standard and the
Roles of the Plan Sponsor and Plan Administrator in
Pension Plan Funding and Investment**

A CONSULTATION PAPER

**Prepared by the Canadian Association of Pension Supervisory Authorities
November 30, 2009**

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EXECUTIVE SUMMARY

One of the strategic initiatives of the Canadian Association of Pension Supervisory Authorities' (CAPSA) is to promote consistency in the governance of pension funds and pension plan funding and investment. In its 2008-2011 Strategic Plan, CAPSA states that it will pursue this priority by:

- Examining the issues surrounding the application of the prudent person rule, giving consideration to both the assets and liabilities of pension plans.
- Developing a common approach to funding policies by recognizing the link to fund governance.

The purpose of this paper is to provide guidance and assistance to pension plan sponsors and plan administrators, by making them aware of key issues in pension plan funding and investment. This paper also discusses the roles of the plan sponsor and plan administrator in pension plan funding and investment, and recognizes that a connection exists between pension funding policy and investment strategy. CAPSA is releasing this consultation paper in order to seek input from pension stakeholders.

The roles of the plan sponsor and plan administrator are separate and distinct. However, in many cases both the plan sponsor and the plan administrator roles are fulfilled by the employer, who works with its delegates, employees and agents. When the plan sponsor acts in the plan administrator role, it is important to clearly articulate and document which responsibilities are being performed in each role.

The emphasis of this paper is on:

- Applying the prudent person rule in pension plan investments.
- Using best practices in pension plan funding.
- Documenting and understanding the roles of the plan sponsor and plan administrator in pension plan funding and investment.

Some of these issues may not apply to all pension plans. Although this paper primarily focuses on defined benefit pension plans, it is important to understand that it applies to all types of pension plans – including defined contribution pension plans. Each plan administrator will need to assess which portions of this paper apply to its specific pension plan and act accordingly.

BACKGROUND

In October 2004, the Canadian Association of Pension Supervisory Authorities (CAPSA) released *Guideline No.4: Pension Plan Governance Guidelines and Self-Assessment Questionnaire* to assist pension plan administrators in meeting their governance responsibilities, by achieving and maintaining good governance practices.

Good pension plan governance requires control mechanisms that encourage good decision making, proper and efficient practices, clear accountability, and regular review and evaluation. It contributes to positive pension plan performance and demonstrates due diligence by the plan administrator.

Promoting consistency in the governance of pension funds and funding is a strategic initiative of CAPSA. In its 2008-2011 Strategic Plan, CAPSA states it will pursue this priority by:

- Examining the issues surrounding the application of the prudent person rule, giving consideration to both the assets and liabilities of pension plans.
- Developing a common approach to funding policies by recognizing the link to fund governance.

Project Objective

The purpose of this paper is to provide guidance and assistance to pension plan sponsors and plan administrators, by making them aware of key issues in pension plan funding and investment. As there are a wide range of issues, CAPSA recognizes that some of these issues may not apply to all pension plans. Although this paper primarily focuses on defined benefit pension plans, it is important to understand that it applies to all types of pension plans – including defined contribution pension plans. The paper also has an educational component regarding best practices for pension plan funding and investment.

After the consultation process has concluded, CAPSA plans to develop three guidelines on the best practices that apply to pension plan funding and investment. The first guideline will examine best practices for funding policies, the second guideline will examine best practices for investment policies, and the third guideline will deal with the focus of examinations by pension regulators as they apply to funding and investment processes. Appropriate checklists in support of the guidelines will also be developed.

CAPSA is providing additional guidance on the application of the prudent person rule to investment processes and best practices for funding activities, to achieve consistent governance. This includes guidance on how the plan administrator and plan sponsor can demonstrate that their processes and practices meet these expectations. Since plans of different types and sizes may require different governance practices, the plan administrator and plan sponsor need to adapt their governance practices to their specific circumstances and resources.

Guideline No. 4 identifies the plan administrator's responsibilities as a fiduciary, which include acting with the same care, skill and diligence of a prudent person. As defined in *Guideline No. 4*, the *plan administrator* is the individual, group, body or entity that is ultimately responsible for the oversight, management and administration of the pension plan and its pension fund. The plan administrator may be the employer(s) who established the plan, a pension committee, a board of trustees, an insurance company, a bargaining agent, or another body established by law. In any case, the plan administrator is fully responsible for managing the pension plan and is ultimately accountable to all participants. This includes, but is not necessarily limited to:

- the plan's sponsor (the individual, body or entities that establish and/or continue to sponsor the pension plan),
- pension plan members and beneficiaries,
- bargaining agents, and
- government regulators.

Dual Role of the Employer/Plan Sponsor

For many pension plans, the *plan administrator* is the *employer* who is sponsoring the plan. In these situations, the *employer* is held to a fiduciary standard of care when acting as the *plan administrator*. However, the *employer* also retains certain rights and powers in respect to the pension plan, since it is both the *employer* and *plan administrator*.

The employer assumes different tasks in its role as the *plan administrator*, than in its role as the *employer* or *plan sponsor*. As *plan administrator* the employer is a fiduciary whose actions and decisions must be made in the best interests of the plan's beneficiaries. However, in the *plan sponsor* role the employer is entitled to act in the business' best interests.

The roles and responsibilities of the *plan sponsor* are very different from those of the *plan administrator*. In the *plan administrator* role, the employer must ensure the pension plan and fund are administered in accordance with pension plan documents and that legislation is followed. In the *plan sponsor* role, the employer is responsible for designing the pension plan, setting the benefit structure for various classes of members, and establishing, amending, or terminating the pension plan. During these activities, the *plan sponsor* is not held to a fiduciary standard of care when dealing with plan members. Although the *plan sponsor* can act in its own self-interest, it may be subject to an implied duty of good faith, which requires it to act appropriately.

For single employer pension plans, the *employer* is typically the *plan's sponsor*, however, other arrangements are possible (e.g., a union or other legislated body can be the pension plan's sponsor). For multi-employer pension plans (MEPPs), the *employer* usually consists of several businesses who participate in the pension plan. These businesses typically have union-negotiated or collectively-bargained plans, and joint labour-management or 100 per cent union trustees.

To avoid confusion about whether a particular action or decision is being carried out as the *plan sponsor* or *plan administrator*, the employer should clearly document the responsibilities for each role. To accomplish this task, the *plan sponsor* needs a clear understanding of both roles and their accompanying responsibilities.

The Role of the Plan Sponsor

Pension plans are established and maintained by plan sponsors in the context of their business and workforce objectives. When the plan sponsor acts in the *employer* role, its interests are allowed to conflict with those of plan beneficiaries – even though it should be acting in the best interests of plan beneficiaries in the *plan administrator* role.

For example, there is no legislated obligation to provide a certain minimum level of pension benefits. As a result, the plan sponsor is responsible for determining – either independently or through collective bargaining – the design of the pension plan, as well as the level and nature of pension benefits. When making these decisions, the plan sponsor should consider:

- the type of pension plan it wants to provide (e.g., defined benefit, defined contribution or a combination of both types);
- the classes of employees that are eligible for plan membership;
- the total cost of the pension plan;
- whether employees should be required to make pension contributions;
- if so, how costs will be shared by the employer and its employees;
- how much should be spent on employees' pension benefits, as a percentage of their salaries;
- the level of risk that should be assumed in providing the benefits;
- how a surplus should be utilized; and
- the plan sponsor's funding obligations.

The plan sponsor also makes other important decisions that may conflict with the best interests of plan beneficiaries (e.g., amending, merging, splitting, winding-up or terminating the pension plan).

The Role of the Plan Administrator

The plan administrator is responsible for the overall administration of the pension plan. This includes managing the pension fund and investing funds in accordance with the terms of the plan and applicable legislation requirements.

As a fiduciary, the plan administrator will generally have the following obligations to plan beneficiaries:

- A duty of loyalty and utmost good faith.
- A duty to act reasonably and prudently, and to have candour and diligence.
- A duty not to profit from its fiduciary position (this is not an absolute prohibition if collateral benefits are properly disclosed).
- A duty not to let personal interests conflict with beneficiaries' interests.
- A duty to treat all beneficiaries fairly and in an even-handed manner.
- A duty to provide information to beneficiaries.

The plan administrator's specific funding and investment duties include:

- Ensuring contributions to the pension fund are made within prescribed timelines, and in accordance with the terms of the plan, legislation and the actuarial valuation filed with the regulator.
- Providing the custodian of the pension fund a summary of the required contributions for a plan fiscal year.
- Ensuring the pension fund's assets are invested in accordance with prescribed requirements.
- Adopting and regularly reviewing a statement of investment policies and procedures.
- Selecting and monitoring service providers that are responsible for implementing funding and investment policies.
- Monitoring the investment managers' performance and compliance with the plan's investment policies and applicable legislation.
- Filing actuarial valuations.

Following Guideline No. 4

Plan administrators need more detailed information on prudent governance practices to improve their funding and investment processes. In particular, each pension plan should have documented processes and standards to comply with plan documents and legislative requirements, such as the prudent person rule.

Plan administrators should follow *Guideline No. 4: Pension Plan Governance Guidelines and Self-Assessment Questionnaire*, as aspects of these 11 pension governance principles are applicable to funding and investment processes. The specific CAPSA governance principles that apply to funding and investment processes are listed below:

Principle 3: Roles and responsibilities

The plan administrator should clearly describe and document the roles, responsibilities, and accountability of all participants in the pension plan governance process.¹

Key Point

- Have clear documentation for funding and investment processes.

¹ The Canadian Association of Pension Supervisory Authorities. "Guideline No. 4: Pension Plan Governance Guidelines and Self-Assessment Questionnaire." 25 October 2004: 5.

Principle 4: Performance measures

The plan administrator should provide for the establishment of performance measures and for monitoring the performance of participants who have decision-making authority in the governance process.²

Key Points

- Regularly monitor the performance of all key decision makers and evaluate them against set performance measures.
- Conduct a regular review of performance measures.

Principle 5: Knowledge and skills

The plan administrator, directly or with delegates, has a duty to apply the knowledge and skills needed to meet governance responsibilities.³

Key Point

- Fulfill funding and investment functions by having plan administrators and delegates apply their knowledge and skills.

Principle 6: Access to information

The plan administrator and, as necessary, any delegates should have access to relevant, timely and accurate information.⁴

Key Point

- Ensure plan administrators and delegates have access to timely, relevant and accurate information.

Principle 7: Risk management

The plan administrator should provide for the establishment of an internal control framework, commensurate with the plan's circumstances, which address the pension plan's risks.⁵

Key Points

- Have written policies on documentation, record keeping, costing, funding and investment.
- Monitor and assess fees to make sure they are reasonable and competitive.

Principle 8: Oversight and compliance

The plan administrator should provide for the establishment of appropriate mechanisms to oversee and ensure compliance with the legislative requirements and pension plan documents and administrative policies.⁶

Key Point

- Ensure that all funding and investment activities meet the plan's terms, administrative policies and legislative requirements.

² The Canadian Association of Pension Supervisory Authorities 5.

³ Ibid.

⁴ Ibid.

⁵ Ibid.

⁶ Ibid.

Principle 9: Transparency and accountability

The plan administrator should provide for the communication of the governance process to plan members, beneficiaries and other stakeholders to facilitate transparency and accountability.⁷

Key Points

- Facilitate transparency and accountability by communicating funding and investment processes to plan members, beneficiaries and other stakeholders.
- Report results to appropriate stakeholders.

Principle 10: Code of conduct and conflict of interest

The plan administrator should provide for the establishment of a code of conduct and a policy to address conflicts of interest.⁸

Key Point

- Develop a code of conduct which sets out required behaviour, a control procedure for conflicts of interest and provisions for due process.

Principle 11: Governance review

The plan administrator should conduct a regular review of its plan governance.⁹

Key Points

- Periodically review funding and investment procedures and practices to assess their effectiveness in comparison to the stated objectives.
- Modify the policies and procedures after each review (as required), to enhance their effectiveness.

THE PRUDENT PERSON RULE

The prudent person rule is a substantive rule of law that is composed of several basic duties and principles. In the pension plan context this rule includes:

- A duty to act prudently and with due diligence when managing the pension fund and its assets.
- A duty of loyalty to the pension fund and its members.
- A duty to be fair and even-handed when dealing with competing interests.
- A duty to apply the principle of diversification, which requires the pension fund's investment portfolio to be suitably diversified and avoid unwarranted risk.

The application of the prudent person rule is intended to lead to balanced decision making, rather than dictate particular outcomes. It applies to all of the plan administrator's duties and obligations related to the pension plan or fund. The prerequisites associated with the successful implementation of the rule include an effective governance framework, which consists of supervising and monitoring participants, policies and performance. Since the prudent person rule emphasizes processes, it places a premium on the governance structure, deliberate decision making and appropriate documentation.

⁷ Ibid.

⁸ Ibid.

⁹ Ibid.

According to the Organisation for Economic Co-operation and Development (OECD) journal *Financial Market Trends*, the prudent person rule is generally stated the following way:

*A fiduciary must discharge his or her duties with the care, skill, prudence and diligence that a prudent person acting in a like capacity would use in the conduct of an enterprise of like character and aims*¹⁰.

The specific legislation for each Canadian pension jurisdiction may have different definitions for the prudent person rule. For more details, please refer to the *Legislative Framework* section of this paper.

Applying the Prudent Person Rule

A key element of the prudent person rule is its emphasis on fiduciaries exercising due diligence. This includes making decisions based on proper consideration of adequate information and documenting the final decision, along with the reasons and the circumstances that were considered.

When fiduciaries exercise prudence they will be judged solely by whether they have followed a reasonable and prudent process in reaching their decisions, with consideration of the circumstances. If fiduciaries do not personally possess all of the skills, information and knowledge that are necessary to properly carry out their duties, they should seek assistance from experts or third parties. In some cases this may require delegation of tasks.

An important part of the successful implementation of the prudent person rule is the ability of the plan administrator, plan sponsor, regulator and plan members to monitor plan funding against minimum statutory requirements and to assess investment management. In order for effective monitoring to occur, there must be adequate information available. In addition, policies must be established and processes must be documented to support any conclusions and decisions.

As the prudent person rule is a rule of process, it is important that regulators encourage plan administrators to establish good governance practices regarding funding and investment. Although plan administrators have a responsibility to ensure that minimum statutory contributions are remitted, they should also be encouraged to have funding and investment policies, to guide their decision making.

ELEMENTS OF PROCEDURAL PRUDENCE

Pension plans should have written governance documents which include one or more written policies that list the administration procedures that will be implemented and monitored. The documented procedures should:

- Identify responsibilities and accountabilities.
- Outline the process for recommending, approving, and implementing decisions.
- Determine the frequency and format of reporting and performance measurement.
- Outline the method for monitoring compliance with the governance process.

Pension plans should consider having a comprehensive governance document that includes all the pension policies, contracts and agreements.

It is important to keep in mind that the details of these procedures may differ from pension plan to pension plan. The plan administrator should review the details of the procedures to determine which ones are appropriate for its particular pension plan.

¹⁰ Russell Galer, "Prudent Person Rule Standard for the Investment of Pension Fund Assets", *Financial Market Trends*, No. 83, Nov. 2002: 45.

Exercising Care and Skill

When a plan administrator and its delegates have a duty to act prudently, they are required to exercise the same care and skill that a person of ordinary prudence would exercise in dealing with another person's property. The plan administrator may also be imposed with a statutory standard of care. This is a subjective test that requires the plan administrator to use all relevant knowledge and skills that it possesses, or should possess, due to its profession or business. This standard is higher than one that would be imposed by the common law. As a result, the plan administrator must possess or acquire the level of knowledge and skills that are sufficient to perform its tasks. If a plan administrator does not have the required knowledge or skills, it will often seek and obtain advice from relevant experts. The plan administrator may also delegate activities to those with the required skills, subject to appropriate ongoing oversight.

Making Effective Decisions

Decisions should be made by those individuals or organizations that have the authority, skills, information and resources to effectively make them. If a plan administrator does not have the necessary knowledge to make a decision, it should seek input from experts with the required knowledge and skills. In this case the plan administrator should have sufficient expertise and appropriate training to critically evaluate any advice that is received.

Risk Management

The long term goal of the pension plan is to have sufficient assets in the pension fund to provide the promised benefits. A plan's main long-term risk is that the fund cannot meet the obligations of the pension promise. Risk should be managed relative to the plan fund and investment objectives when setting investment policy, when implementing the investment policy, and in ongoing performance evaluation on the effectiveness of the investment policy. The objectives need to be well defined so that the risks associated with the objectives will be well understood and steps can be taken to actively manage the risks.

The plan administrator needs to have adequate information to perform its duties to monitor the risks facing the plan and to map out strategies to manage the risks. Some methods for managing this long-term risk could include conducting periodic asset/liability studies and a long-term asset mix policy which is expected to generate a real rate of return above the minimum required real return necessary to fund the present value of all accrued benefits promised to plan members.

Measuring Performance

The plan administrator should:

- Arrange to have the investment performance of the pension fund assessed.
- Conduct formal evaluations of the plan's procedures and decisions that are made about the pension fund.
- Delegate the formal assessment of the fund's performance and decisions to internal and/or external advisers or managers.
- Monitor, measure and evaluate the performance of anyone who administers, manages or has a role in the administration of the fund's assets (e.g., auditors, custodians, lawyers, investment managers, consultants, etc.).
- Consider what is appropriate for the specific plan, when establishing performance measures.

Implementing a Code of Conduct

The plan administrator should establish appropriate controls to:

- Promote the independence and impartiality of its decisions.

- Make sure that all plan members are considered when decisions are made.
- Ensure the confidentiality of sensitive information pertaining to the plan, fund and plan members.
- Prevent the improper use of privileged or confidential information.

These goals should require entities to observe high standards of integrity, honesty and fair dealing. They should also be implemented through the code of conduct that is established for the plan – which should describe how conflicts of interest will be dealt with. To verify compliance with the code of conduct, internal review mechanisms can be put in place.

Understanding Conflicts of Interest

A conflict of interest includes any situation where a plan administrator has or could reasonably be perceived to have, an incentive to decide a matter or provide a recommendation, for any reason that is not in the beneficiaries' best interests, or that is in the plan administrator's own interests. However, if a plan administrator receives a collateral benefit, this does not necessarily indicate that the plan administrator did not act in the best interests of the plan's beneficiaries.

The plan administrator has a fiduciary responsibility to protect the pension fund from actual and potential conflicts of interest. This includes ensuring informed decisions are made in the best interests of the fund's beneficiaries, with respect to the pension fund's assets.

Having a Conflict of Interest Policy

The plan administrator should develop a conflict of interest policy that identifies, monitors and manages conflicts of interest. This policy should:

- Be in place before conflicts occur.
- List all individuals who are likely to be involved in plan decision making.
- Require the plan administrator to clearly document any actions that are being taken to manage the conflict when it is first discussed.
- Provide examples of the types of conflicts that may arise, to assist the plan administrator and its delegates in identifying circumstances or events that may cause a conflict. (This will allow the plan administrator to implement appropriate measures to monitor and manage conflicts of interest.)
- Have a disclosure system that outlines when, how and to whom a conflict of interest will be disclosed. It should also deal with the conduct of the individual until the conflict is resolved.

Delegating Responsibilities

Each plan administrator should assess whether it has the right structures, processes and skills – both individually and within the organization – to effectively carry out its role. If tasks need to be delegated to others, it is important that they be properly delegated, as key elements of the governance system are the acts that are required in administering the pension plan, and investing and administering the pension fund.

If a plan administrator decides to delegate certain tasks – to third parties, internal committees or staff – the authority to delegate should be clearly set out in a written document. These delegations should be reasonable and prudent, and the individuals who are delegated tasks should have the proper skills to carry them out.

Each delegation should be set out in a written document that details the specific responsibilities that are delegated to others. The document should include information on the authority of the delegate, such as any right to sub-delegate responsibilities to others. This documentation could be or must be (if required by legislation) made available for inspection and review by eligible parties, such as plan members, beneficiaries and government regulators.

Although operational duties may be delegated, the plan administrator ultimately remains responsible for ensuring that pension funds are fulfilling their main objective of paying retirement benefits. The plan administrator cannot delegate accountability for direction setting and supervision. However, it can ask for assistance in performing these tasks.

When delegating responsibilities, the plan administrator remains responsible for monitoring and reviewing the delegated activities, to ensure they have been appropriately and prudently carried out. This includes monitoring and reviewing service providers based on established policy and review procedures.

Selecting Service Providers

The plan administrator may retain service providers to perform delegated duties. If service providers are used, the plan administrator should have written contracts or agreements with them. This will ensure that appropriate expertise is retained and that the fees charged are reasonable and commensurate for their level of expertise. In some instances, employers and pension plans may decide to provide these services internally. In either case, the plan administrator should have adequate criteria for selecting, monitoring and (if appropriate) replacing service providers who have been delegated tasks associated with the administration and investment of the pension fund.

If a third party is responsible for providing advice and services related to the administration of the pension plan it will owe fiduciary-like duties to pension plan beneficiaries that are over and above its contractual obligations. The service provider is performing plan administrator functions which have fiduciary obligations to plan beneficiaries.

Monitoring

The plan administrator is responsible for:

- Identifying which responsibilities should be delegated.
- Determining who should be assigned these delegated tasks.
- Negotiating the terms of the delegation agreement.
- Monitoring the performance of the individual or business that has been delegated tasks.

To monitor the plan and fund for compliance with statutory requirements and policies that have been adopted by the plan administrator, sufficient information should be provided to appropriate individuals, and an effective reporting and disclosure regime is needed. To monitor an activity, transaction or investment, appropriate mechanisms should be in place. In addition, policies themselves should be monitored to ensure they are being followed.

The plan administrator should consider the following factors when evaluating both internal and external service providers:

- Whether the service provider has met the terms of the contract.
- Whether information is accurately communicated in a timely manner.
- Whether transactions are accomplished in a cost-effective, efficient and timely manner.
- Whether compensation is reasonable.
- Whether the work is satisfactory and performed in accordance with industry standards.

Documenting Processes, Procedures and Policies

The pension plan needs clear documentation of the roles of the plan sponsor and plan administrator, as well as the rights of plan members and beneficiaries, with respect to the governance of the pension plan and fund. The plan administrator should set up a process for documenting decisions and activities, and have documented

processes, procedures and policies, to help demonstrate that the prudent person rule has been met and obligations have been fulfilled. Any time a decision is made, it should be well documented, and include the reasons and circumstances that were considered. Plan administrators are also advised to keep detailed meeting minutes that include the nature of the discussions, the items that were considered and the decisions that were made. This documentation should be sufficient to facilitate an independent confirmation that due diligence was applied, and to support the positions and conclusions that were made.

Communication

Plan administrators should consider having a communication policy that takes into account any legislative requirements. Communication for a funding policy should consider whether and how the policy would be communicated to plan members and what information would be provided. This information could help plan members understand the factors that affect the variability of funding costs, as well as the risks that are faced by pension plans. It could also help plan members appreciate the funding decisions that are made by their plan sponsor or plan administrator.

Key Points

Does the plan administrator:

- Have documented procedures in place that outline responsibilities and decision making processes.
- Investigate or evaluate investment options to make informed decisions.
- Ensure it has and/or uses appropriate expertise to make investment decisions.
- Evaluate each investment in the context of the plan's portfolio and its statement of investment policies and procedures.
- Monitor risks facing the plan and map out strategies to manage the risks.
- Exercise proper due diligence to control fees and incurred costs.
- Monitor, measure and evaluate the performance of the fund and service providers.
- Follow an established code of conduct, which also deals with conflicts of interest.
- Have procedures in place for delegation of tasks and responsibilities.
- Apply the prudent person rule to the administration of the pension plan and fund, and the investment of the pension fund's assets.
- Have an established communication policy.

FUNDING

Pension Funding Principles and Objectives

The minimum funding requirements for pension plans that provide defined benefits are intended to provide assurance that sufficient assets will be maintained to deliver the promised pension benefits on an ongoing basis. This is particularly intended to protect pension benefits in situations that involve employer insolvency or bankruptcy. Different considerations may apply to single employer pension plans, than to MEPPs, in some aspects of funding. For the purpose of this paper, MEPPs are defined as pension plans that have negotiated contributions for a specific period of time, under the terms of collective bargaining agreements.

Funding requirements promote benefit security. Due to the emphasis on solvency funding and the fact that plan solvency liabilities are market-driven, funding rules can result in a large potential for annual fluctuations in funding requirements. For single employer pension plans, these fluctuations can be dealt with by adjusting contribution levels. For MEPPs, benefit levels rather than contribution levels, will typically need to be adjusted.

Plan sponsors generally seek year-to-year funding requirements that are as stable and predictable as possible, given the variability resulting from investment experience, interest rate changes and other factors. For MEPPs, although contribution levels are fixed, a lack of stability in minimum funding requirements can translate into fluctuating benefit levels.

Funding decisions have a significant impact on the stakeholders of a pension plan. These decisions impact the pace of funding, the security of members' benefits, and the ongoing viability of the plan itself. Therefore, they should not be made on an ad hoc basis. Practical financing considerations and other laws and rules that affect pension plans and plan sponsors, may also affect or impose constraints on funding decisions.

The funding policy should support the decision making process, which should be consistent with the purpose and goals of the pension plan. The plan sponsor is responsible for funding the pension plan and is strongly encouraged to establish and adopt a funding policy.

Developing a Funding Policy

In Canada, minimum pension standards legislation requires plan administrators, as a rule, to adopt a statement of investment policies and procedures (SIP&P). Although it is not a requirement under any current pension legislation, it is a good practice and an integral part of the pension plan's governance structure, for plan sponsors of defined benefit pension plans to develop and adopt a funding policy.

Defined contribution pension plans may face funding issues because employee and employer contributions may or may not be adequate to produce the post-retirement income level that was initially intended. Therefore, plan sponsors are advised to periodically review the adequacy of the contributions, to determine if they will meet the target income levels.

There are a number of advantages for developing a funding policy:

- The exercise of developing a funding policy should improve the plan sponsor's and other parties' understanding of the risks involved and the factors that affect the variability of funding requirements and security of benefits. As a result, the plan sponsor should improve its identification and management of risks, which should lead to more robust governance.
- The adoption of a funding policy could increase the plan sponsor's discipline around funding decisions. This could contribute to more stability in funding and reduce the risk of intervention by regulators.
- Having a written summary of the funding policy that is accessible to plan members and beneficiaries will improve the transparency of funding decisions.

- Having a funding policy also provides guidance to the plan's actuary when he/she is selecting actuarial assumptions in accordance with actuarial standards of practice and within the plan sponsor's risk tolerance limits.

The SIP&P details the plan administrator's objectives and expectations relating to the plan's assets. The funding policy deals with matters relating to the plan's liabilities and contributions, and documents the plan sponsor's funding objectives and methods for achieving them. The specifics of the SIP&P should be considered when setting the funding policy. It is important to ensure that the two documents are consistent with each other and changes may be required to either the SIP&P or the funding policy to achieve consistency.

The party responsible for the adoption and maintenance of the funding policy may vary according to the circumstances of the plan. For most single employer pension plans, the employer is ultimately responsible for funding decisions and should therefore be responsible for the development of the funding policy. The employer should provide the funding policy to the plan administrator, as the plan administrator has certain responsibilities once the funding policy is adopted (e.g., implementing the communication of the funding policy to plan members in accordance with the communication approaches outlined in the policy). For MEPPs, the plan administrator would typically be responsible for the adoption of the funding policy. However, there may be situations where responsibilities are shared between different parties and the funding policy might be covered by more than one document. In either case, the funding policy should clearly define the roles the plan sponsor and plan administrator have in its establishment and implementation.

Elements of a Funding Policy

When plan sponsors document their funding objectives, they should outline their understanding of the risk factors that influence future financing obligations, their risk tolerance, and specific policies related to matters that affect the funding of the pension plan.

When any CAPSA guideline is adopted, it should be treated as a best practice for issues that should be covered in a funding policy. Ideally, the written funding policy should, at a minimum, address the following issues, to the extent that they are relevant to the circumstances of the plan.

1. Funding Objectives

The funding policy should indicate how the funding objectives integrate with the plan's SIP&P, as well as the plan sponsor or plan objectives. These objectives can be stated as they relate, for instance, to benefit security, stability of contributions, and to contribution or benefit levels. The policy could also document circumstances in which funding in excess of the legislated minimum would be considered.

2. Key Risks Faced by the Plan

The funding policy should describe the key risks that are faced by the plan from the perspectives of various stakeholders. These risks can include, for example, the extent to which the plan's assets are mismatched against its liabilities, and the demographic characteristics of the plan's members. Due consideration should be given to how these risks may affect the security of members' benefits.

3. Funding Volatility Factors and Management of Risk

The funding policy should document the structure of the plan's liabilities as it affects funding risk. It should also describe the plan sponsor's tolerance for volatility in funding requirements, while taking into account the characteristics of the plan's benefits, and the link between the plan's liabilities and its investment policy. The policy could include any scenario testing techniques that are used to evaluate the effect of different hypothetical situations on the plan's funding position and requirements. Details on scenario testing techniques could include the frequency, the timeline for projections and the specific risks that are being evaluated.

4. Funding Target Ranges

The funding policy should describe any funding targets, contribution target levels and established cost sharing arrangements (if they are relevant to the plan's structure). The funding targets can be expressed in relation to liabilities for a going concern, solvency, wind-up, or some other measure, depending on the plan's funding objectives. The funding policy can also describe any mechanisms that would allow flexibility in funding and accommodate potential short term operational requirements.

5. Cost Sharing Mechanisms

If relevant, the funding policy could include considerations for cost sharing mechanisms between plan members and the employer. This could include establishing total target contribution levels and determining the extent to which costs will be shared between both parties.

6. Utilization of Funding Excess

The funding policy should describe the plan sponsor's policy on using funding excess for an ongoing entity, and if appropriate, could cover its use in the event of plan termination. If funding excess can be used for contribution holidays or benefit improvements, the policy should establish the factors that may be considered in deciding how and when to use the funding excess. This includes any desired margins that the plan sponsor wishes to keep before using the funding excess.

7. Multi-Employer Pension Plans (MEPPs)

Although each of these factors apply to all defined benefit pension plans, special considerations apply to MEPPs. The funding policy for a MEPP should describe the approach followed to set benefit levels and issues relating to the use of fixed contributions. These issues could include how the plan's financial position affects benefit levels and in what manner benefit levels may be adjusted. These plans should also document the respective roles of trustees, employers and collective bargaining agents (as applicable), in the various decisions that need to be made. The issues of intergenerational equity and policy on benefit reductions or restructuring (when applicable), should also be discussed. Similar issues may apply to other plans, such as jointly-sponsored pension plans, and where relevant, the funding policy should include a discussion of such considerations.

In the discussion of other elements of the funding policy for a MEPP any role that is assumed by the plan sponsor would be assumed by the plan administrator.

8. Actuarial Methods and Assumptions

The plan sponsor can provide useful guidance to the plan actuary in selecting actuarial assumptions and methods that are appropriate for the plan sponsor's risk management approach (e.g., the going concern actuarial cost method, any desired margins, or provision for adverse deviations and acceptable asset valuation methods and ranges). The plan administrator would provide information on data, investments, historical experience, etc. to assist the actuary in developing these assumptions. This combined input would normally be reflected in the actuary's selection of assumptions and methods – in particular, the margins for adverse deviations – provided they do not lead to assumptions that deviate from accepted actuarial practice.

The actuary's report would normally outline the range of contributions that are permitted. This includes the minimum contributions that are required under applicable pension standards legislation and the maximum contributions that are permitted under tax statutes. As a result, the plan sponsor would need to make additional decisions that could be guided by the plan's funding policy.

9. Frequency of Valuations

The plan sponsor may establish standards for the frequency of valuations, both for internal monitoring purposes and for the production of reports that are filed with regulators.

10. Monitoring

Management and implementation issues around the establishment and ongoing maintenance of the funding policy should be documented. This includes documenting the roles, responsibilities and oversight of the funding policy, as well as the frequency of review.

11. Communication Policy

Sharing funding information is strongly encouraged. To communicate this information, the plan sponsor or plan administrator must consider who would receive the information, what information would be made available and when. If a summary of the plan's funding policy is accessible to plan members, it can help them understand the factors that affect the security of members' benefits and the variability of funding costs, as well as the risks that are faced by both their pension plan and others. In addition, it can help members appreciate the funding decisions that are made by their plan sponsor or plan administrator.

Key Points

- Has the plan sponsor adopted a funding policy
- Does the funding policy include the following elements:
 - funding objectives
 - key risks faced by the plan
 - funding volatility factors and management of risk
 - funding target ranges
 - cost sharing mechanisms
 - utilization of excess funds
 - actuarial methods and assumptions
 - frequency of valuations
 - monitoring
 - communication

INVESTMENT

Pension Investment Principles and Objectives

The manner in which assets are invested, and the way the investment is regulated and supervised, are crucial to the success of the pension fund. The investment management function is undertaken in accordance with the prudential principles of security, profitability and liquidity, while using appropriate risk management concepts. The prudent investment of pension plan assets will take into account the nature of the pension plan's liabilities, including the timing of pension payments, the plan's expected future experience and its demographics.

As a fiduciary, the plan administrator is responsible for the prudent investment of the pension fund's assets, and should establish, implement and adhere to policies and practices that meet that responsibility.

The Legislative Framework

Each jurisdiction has its own legislation that governs registered pension plans. This legislation sets out the role of the plan administrator and related standard of care with respect to the pension plan and pension fund. It also includes general and specific requirements for investing the pension fund's assets consistent with the requirement to make investments in accordance with specific limits and restrictions that are set out in regulations, and requires consideration of the nature of the plan's liabilities. In addition, it may include the requirement to invest the pension fund's assets in the same manner that a prudent person would invest the plan's portfolio of investments. (In this regard, it is the legislative intent that prudence applies to the investment portfolio as a whole, as opposed to any particular investment on its own.)

The following table outlines the relevant sections of each jurisdiction's legislation and regulations as of August 2009.

Jurisdiction	Statute	Standard of Care	Investment
Federal	Pension Benefits Standards Act, 1985 (PBSA)	s. 8(4)**, 8 (5)	s. 6 and 7 s. 8(4.1)++ Schedule III
Alberta	Employment Pension Plans Act	s. 13(5)	Schedule III PBSA EPPA Regulation s. 50-52 EPPA s. 54++
British Columbia	Pension Benefits Standards Act	s. 8(6), 8(5) **	Schedule III PBSA PBSA s. 44++ PBSA Regulation s. 38
Manitoba	Pension Benefits Act	s. 28.1(2) ++ s. 28.1(2.1) s. 28.1 (3) and (4)	Schedule III PBSA PBA Regulation s. 16
New Brunswick	Pension Benefits Act	s. 17(1)++ s. 17(2)	s. 17 Regulation s. 44-46
Newfoundland and Labrador	Pension Benefits Act	s. 14(1)	Schedule III PBSA PBA Regulation s. 39

Nova Scotia	Pension Benefits Act	s. 29(6), 29(1)++	Schedule III PBSA PBA Regulation Schedule I
Ontario	Pension Benefits Act	s. 22(1)++ s. 22(2), (3) and (5)	Schedule III PBSA PBA Regulation s. 66, 78-79
Quebec	Supplemental Pension Plans Act	s. 151**	sections 151, 168-182 and 307 Regulation s. 61
Saskatchewan	Pension Benefits Act	s. 11(2)(a) and (b) s. 11(2)(c) and (d)	Schedule III PBSA

**This statute provision refers to the prudent person rule.

++This statute provision applies the prudent person rule to investment.

A pension plan's investments must comply with the investment rules under the respective federal or provincial pension legislation. These investment rules apply to both defined contribution and defined benefit pension plans.

Seven out of nine Canadian provincial pension regulators that are members of CAPSA, have adopted the federal investment rules (FIR) that are set out under the federal pension benefits regulations. Quebec and New Brunswick have pension investment rules that are somewhat different from the FIR.

For more details on the legislative provisions in the different jurisdictions, please refer to Appendix A.

Investment Processes and Due Diligence

It is a statutory requirement for the plan administrator to establish a written statement of investment policies and procedures (SIP&P).

Investment management may be examined from a framework of reasonable behaviour. When an investment is made, the prudent person rule applies to the investment of the pension fund's assets. It addresses the behaviour of the plan administrator as fiduciary relating to the investment portfolio, rather than the result (gain or loss) of a particular investment decision. Under this rule, any investment may be permitted without exclusion, if it is selected with care and prudence, and if it complies with legislative restrictions. The plan administrator is not judged by the investment's historical financial performance, but by the reasonableness of its decision making process. After the initial investment decision, the ongoing performance of investments must be monitored.

The focus is on applying prudence when an investment decision is made. This is based on how an investment decision is made, taking into account how the specific investment fits in the portfolio, in the context of the plan administrator's management of the whole portfolio. The mere fact that an investment resulted in a loss, does not automatically indicate that the plan administrator contravened its duties.

The plan administrator's conduct should be evaluated with a perspective based on when the investment decision was made, and not with a viewpoint based on hindsight. The plan administrator's conduct should also be analyzed to determine if it used proper methods to investigate, evaluate and structure the investment, and if the investment was appropriately monitored afterwards. In this context, proper methods are generally those that are consistent with current investment practices, at the time the investment decision was made.

According to *Modern Investment Management and the Prudent Man Rule*, prudence can be described in the following way:

Prudence is a test of conduct not performance ... (a) paradigm of prudence (is) based above all on process.

Neither the overall performance of the portfolio nor the performance of the individual investment should be viewed as central to the (prudence issue). Prudence should be measured principally by the process through

which investment strategies and tactics are developed, adopted, implemented, and monitored. Prudence is demonstrated by the process through which risk is managed rather than by the labelling of specific investments as either per se prudent or imprudent. Investment products and techniques are essentially neutral; none should be classified as prudent or imprudent per se. It is the way in which they are used, and decisions as to their use are made, that should be examined to determine whether the prudence standard has been met ... Prudence is not self-evident. Nor will it be enough to point to their use by other fiduciaries. What matters is not that others have used the product or technique (for whatever reasons), but the basis for its use by the fiduciary in question¹¹.

Under the prudent person rule, the plan administrator has a duty to invest the pension fund's assets in a prudent fashion, in light of the particular needs of the plan and fund.

Key Points

Has the plan administrator:

- Adopted a process for ensuring compliance with legislated requirements.
- Established a statement of investment policies and procedures.

Investment Policy

Although all pension plans are required to have a SIP&P, the investment policy may be covered by more than one document which complements the mandatory SIP&P. For less complex pension plans, the mandatory SIP&P may be sufficient to act as the overall investment policy for the plan. However, more complex pension plans may wish to have a broader investment policy, which includes the mandatory SIP&P as one its components. In this case the overall investment policy would be broader in scope and would provide more details on the administrative procedures that apply to investment functions.

There are many benefits to having an investment policy. It can:

- Communicate the plan administrator's investment philosophy to pension fund managers.
- Describe the objectives for the investments and lending programs.
- Explain the overall risk philosophy for the pension plan.
- Document how investment managers will be chosen, compensated and replaced; thereby encouraging compliance with the policy's goals and procedures.
- Communicate the investment strategy to those who recommend contributions to the fund and evaluate the financial condition of the plan. (These groups may include the plan sponsor, plan actuary, the regulator, plan members and other beneficiaries who wish to assess the amount and security of their stake in the fund.)
- Identify the roles of those involved in the investment process, and what is expected of them.
- Acknowledge intricacies that demonstrate the relationship between funding and investment.

¹¹ Bevis Longstreth, *Modern Investment Management and the Prudent Man Rule* (New York: Oxford University Press, 1986) 111.

For guidance in developing a SIP&P, please refer to the Office of the Superintendent of Financial Institutions of Canada's (OSFI's) Guideline for the Development of Investment Policies and Procedures for Federally Regulated Pension Plans. (Available online at: www.osfi-bsif.gc.ca/app/DocRepository/1/eng/pension/guidance/penivst_e.pdf)

Elements of a SIP&P

The mandatory SIP&P should address the following elements that are prescribed in the FIR:

- categories of investments, including derivatives, options and futures;
- diversification of the investment portfolio;
- asset mix and expectations regarding the rate of return;
- liquidity of investments;
- lending rules for cash and securities;
- retention or delegation of voting rights attached to investments;
- valuation of investments not regularly traded at a public exchange; and
- related party transactions.

The SIP&P needs to be dynamic. Although it is developed by the plan administrator, the SIP&P should take account of the plan sponsor's goals and objectives, and consider the funding policy. Pension legislation requires the SIP&P to be reviewed at least once per year, to determine if any changes are needed. (If required, this review may be conducted more frequently.) The plan administrator should determine whether the portfolio diversification and philosophies for investment and risk are still appropriate and consistent with the funding policy and statutory requirements.

All parties who are responsible for the overall implementation of the SIP&P should be identified, along with any other important parties that will be part of the investment management process. The SIP&P needs to address whether internal or external investment managers will be used, the extent of their activities and authority, the process by which they will be selected and how their performance will be monitored. If external managers are used, an investment management agreement ought to be required.

If a pension plan provides components of both defined benefit and defined contribution pension plans, it may be appropriate to have separate documentation for each part.

Key Points

The plan administrator should:

- Consider the prescribed elements of the FIR when preparing the SIP&P.
- Think about the plan sponsor's goals and objectives, and consider the funding policy (if one exists) when developing the SIP&P.
- Make provisions for annual reviews of the SIP&P.

Asset Allocation

Asset allocation is a key element in determining long run investment performance and outcomes. It should reflect the characteristics of the pension plan's liabilities, expectations regarding risks and characteristics of the pension fund's expected rate of return. Decision makers should also consider a full range of possible investment opportunities.

For each asset class in which the fund is invested, decision makers should consider whether active or passive management would be more appropriate, given the efficiency, liquidity and level of transaction costs in the given market. For active management, consideration should be given to what expertise is required and whether the decision makers possess the necessary expertise.

Key Point

- The plan administrator should determine the asset allocation for the pension fund after considering desired risk parameters, objectives for the rate of return and implications for funding pension benefits.

Investment Manager Retention

The plan administrator or its delegate should agree with investment managers on an explicit written mandate that covers:

- the objective, benchmarks and risk parameters, that together with all the other mandates, are coherent with the pension fund's overall objective and risk tolerance;
- the manager's approach for achieving the objective; and
- clear timelines for performance measurement and evaluation.

Key Point

- The plan administrator should exercise independent judgment and use acceptable standards in retaining qualified experts and consultants.

Related Party Transactions

Related party transactions are generally prohibited by pension regulators, subject to certain exceptions. The purpose of this restriction is to safeguard the interests of plan members and beneficiaries.

Procedures should be established by plan administrators to identify related party transactions that are permitted by pension regulations. Where exceptions are permitted, criteria should be established to identify how exceptions will be determined (e.g., nominal and immaterial transactions).

Key Points

The plan administrator should:

- Develop procedures to ensure compliance with restrictions on related party transactions.
- Create specific criteria that define which related party transactions are permitted and how they will be managed.

Investment Selection Process

As the plan administrator retains responsibility for investing pension plan assets, it may delegate investment management functions to internal or external parties. External investment managers may carry out investment selection, with broad oversight and direction being provided by the plan administrator. The plan administrator may have internal parties performing investment functions.

When choosing investments, the plan administrator or its delegate should have regard for:

- a) the need to appropriately diversify investments for the pension plan;
- b) the type of investments that are suitable for the pension plan; and
- c) the particular investment's suitability.

The plan administrator or its delegate may obtain expert advice regarding the investments and should act in accordance with the SIP&P.

When assessing an investment, the plan administrator or its delegate should give appropriate consideration to all relevant factors. This involves employing proper methods for investigating, evaluating and structuring investments, and exercising independent judgement when making investment decisions.

When considering particular investment decisions, the plan administrator or its delegate should use appropriate investigative methods and review these decisions once they have been implemented. At a minimum, the plan administrator or its delegate should:

- Undertake a thorough and impartial investigation to determine the advantages and disadvantages of a particular investment.
- Obtain sufficient information about an investment to make an informed decision.
- Consult with qualified experts and/or consultants, either internally or externally.
- Assess whether the investment will advance the plan's purpose, in the context of its overall investment portfolio.
- Compare the potential investment or transaction to other available options.
- Monitor the investment on a regular basis with reasonable diligence.
- Make adjustments on a regular basis to ensure compliance with the SIP&P and legislation.
- Divest investments when appropriate.

Key Points

The plan administrator or its delegate should:

- Carry out a complete, independent and thorough investigation to determine the advantages and disadvantages of a particular investment, before making an investment decision.
- Exercise proper due diligence.
- Use or exceed prevailing industry standards when investigating the merits of the investment or transaction.
- Utilize appropriate methods to evaluate the investment.
- Obtain sufficient information to make an informed decision.
- Verify that information that is relied on to make investment decisions is complete and up-to-date.
- Seek advice and counsel of independent, qualified experts and/or consultants, and provide them complete and accurate information.
- Exercise independent judgment when relying on the given advice.
- Review the investment or transaction in an arm's-length fashion and compare it to other options.
- Assess whether the investment will advance the plan's purpose, objectives and funding policy.
- Examine the investment in the context of the overall pension fund portfolio, the legislated requirements and consistency with the SIP&P.
- Adopt an exit strategy for investments.

Monitoring

Although the plan administrator may delegate investment responsibilities to investment professionals, it is not free from the duty to monitor the delegated authority. This duty includes monitoring and reviewing investment

managers based on the established investment policy and reviewing procedures. It also requires the plan administrator to exercise control after the decision to delegate is made and the investment advisor is chosen.

The plan administrator or its delegate should:

- Carefully investigate, evaluate and select the investment manager.
- Adequately monitor the performance of the investment manager.
- Completely assess the investment manager's performance and compare it to the performance of other managers.
- Periodically re-evaluate the investment manager's performance.
- Regularly monitor compliance with policies, procedures and legislative requirements.

If a delegate is acting on behalf of the plan administrator, these findings should be reported directly to the plan administrator.

Key Points

The plan administrator or its delegate should:

- Use acceptable standards in retaining, monitoring and/or supervising qualified experts and consultants.
- Monitor the performance of investment managers, service providers, employees or other individuals who have been delegated investment authority.
- Implement adequate procedures to monitor agents, service providers and employees who have been delegated fiduciary responsibilities.
- Use documented procedures that measure how well the plan's investment strategy was applied; demonstrate portfolio management that is consistent with the plan's objectives and funding policy; and help establish the financial soundness of the fund.

Benchmarking

It is important to select an appropriate benchmark for measuring the fund's investment performance as a whole. In addition, the plan administrator should consider establishing benchmarks for its investment managers individually. When establishing benchmarks for investment managers, the plan administrator should consult with the investment managers, to jointly determine if the selected benchmarks are appropriate. If the selected benchmark is not a recognizable industry standard, there should be documentation that explains the reasons for selecting the benchmark.

Key Points

The plan administrator or its delegate should:

- Select a benchmark for the pension fund as a whole.
- Establish benchmarks for internal and external investment managers.
- Establish the benchmark before the investment manager performs any work.
- Keep records for investment performance data that is being collected, assessed and compared to the selected benchmark.

Investment Review Process

Pension fund investments should be reviewed at least annually to determine:

- If the investments as a whole are in compliance with the legislation.
- If the investments as a whole are in compliance with the SIP&P.
- If any particular investment falls outside the parameters of the legislation or the SIP&P, or falls below the applicable ratings set out in the SIP&P.
- If the asset mix requires rebalancing.
- If the investments need to be audited.
- If investments reported in the financial statements for the plan are in compliance with the legislation and the SIP&P.

Defined *benefit* pension plan administrators need to:

- Examine the pension fund investment portfolio to determine if it remains appropriate.
- Decide if the current asset mix and philosophies for investment and risk are still suitable.
- Look at the demographics of plan members and review market conditions, to determine if the investment portfolio or options need to be changed.

Defined *contribution* pension plan administrators need to:

- Evaluate the available investment options to determine if they are suitable.
- Re-evaluate periodically, if it is beneficial to offer different investment options, or more or less investment choices.
- Look at the demographics of plan members and review market conditions, to determine if the investment portfolio or options need to be changed.
- Gather information on how members are responding to the investments, to determine if additional information needs to be provided.

Key Points

The plan administrator should:

- Have a process for monitoring investments, to ensure they continue to meet plan objectives, comply with legislative restrictions and remain prudent.
- Keep documentation to show it is following the set process for monitoring investments.
- Possess an exit strategy to address any investments outside of the established criteria.
- Keep documentation to show it is applying the plan's investment exit strategy.

REGULATOR EXAMINATIONS AND REVIEW OF FUNDING AND INVESTMENT PROCESSES

When the regulator examines the plan administrator's funding and investment activities, the focus is on the process that was used. During these examinations, the regulator also looks for evidence that the prudent person rule was applied to investments, and that due diligence was exercised for funding and investment activities. The regulator considers these criteria when it:

- Examines delegations and looks for written documentation that specifies what responsibilities have been delegated, who made the delegations, and who received the delegated responsibilities.
- Considers whether the plan administrator has documented its investment decision making process.
- Selects specific investments to evaluate the effectiveness of the investment process and application of the prudent person rule, as well as determine if the investment process has been implemented for these investments.
- Examines any related party transactions to confirm if they are permitted transactions.
- Determines whether a funding policy has been considered or adopted.
- Considers whether the funding policy and the SIP&P are consistent with each other.
- Confirms the SIP&P is being reviewed annually.
- Confirms that the administrator has identified the plan's risks and has undertaken risk management strategies to manage these risks.
- Reviews the processes used by the administrator and sponsor to determine the risk tolerance in respect of the pension plan and its implications for the pension plan's funding and investment policies.
- Establishes whether the plan administrator has documented its selection of the asset allocation method that is being used.
- Considers what records have been created to document the retention of service providers and their duties.
- Confirms if there are documents providing direction for internal employees who are engaged in the investment process.
- Determines the type of agreements and committee mandates that are in place for service providers and employees.
- Establishes how service provider payments and performance are documented.
- Determines whether benchmarks are in place to measure the individual performance of investment managers and the fund performance as a whole.
- Verifies if the plan administrator regularly reports back to the plan sponsor's board of directors, or the delegated body (if required), regarding the agents, consultants and other service providers that are used.
- Establishes if the plan sponsor's board of directors or delegated body have an overall policy on the retention of agents, consultants and other service providers.
- Determines whether a conflict of interest policy has been considered and if the resulting decision is documented.
- Confirms if the conflict of interest policy is being followed.
- Considers whether documents are easy to access and if they are stored in one central location.
- Contemplates to what extent funding and investment documents are being reviewed, updated and followed.
- Considers actuarial valuations to confirm compliance with legislative requirements to ensure consistency with the plan's funding policy.
- Confirms if required contributions have been made to the pension fund.

CONCLUSION

The application of prudence to investment processes results in better governance of the pension plan and pension fund. Prudent practices include exercising due diligence, documenting policies and processes, and regularly reviewing funding and investment activities.

Employers must be aware of their responsibilities and know whether they are acting in the role of the plan sponsor or plan administrator when performing a function. For MEPPs, responsibilities may be shared between different parties, since the employer usually consists of several businesses who participate in the pension plan.

The plan administrator has fiduciary obligations to act in the best interests of the plan's beneficiaries. To achieve this goal, the plan administrator should follow best governance practices. Although delegation is allowed, the plan administrator is ultimately responsible for meeting these obligations, and should therefore monitor any delegated activities. The plan administrator's obligations include: maintaining the desired benefit security level by regularly reviewing the investment policy, acting prudently and seeking professional advice if the required expertise is lacking.

The plan sponsor is responsible for funding the pension plan and is strongly encouraged to establish and adopt a funding policy, and to regularly review and update the funding policy.

Implementing best practices for funding activities promotes benefit security. Funding and investment practices must be able to adapt to the unique circumstances of each pension plan and pension fund.

STAKEHOLDER INPUT

Stakeholders are invited to provide feedback on the following questions:

1. What role should the plan administrator play regarding the funding policy?
2. Has this paper sufficiently set out the elements for the funding policy? If not, are there any additional elements that you would recommend?
3. What role should the plan sponsor play regarding the SIP&P?
4. Under what circumstances should the plan administrator be encouraged to have an investment policy covered by more than one document?
5. Does this paper adequately address what additional elements could be incorporated into the SIP&P?
6. 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?

Please forward your written comments on this CAPSA consultation paper by January 29, 2010 to;

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APPENDIX A

Statutory Standard of Care

Federal

The federal Pension Benefits Standards Act (PBSA) requires the pension plan administrator to act as a trustee when administering the plan and pension fund for the employer, current or former members, and any other individuals entitled to pension benefits under the terms of the plan. [PBSA s. 8(3)] The plan administrator must exercise the same degree of care that a person of ordinary prudence would exercise in dealing with the property of another person. If the plan administrator possesses or should possess, by reason of profession or business, a particular level of knowledge or skill relevant to the administration of the pension plan or pension fund, the plan administrator is required to employ that level of knowledge or skill in the administration of the plan. [PBSA s. 8(4), (4.1) and (5)]

Alberta

The Alberta Employment Pension Plans Act (AEPPA) states that the plan administrator stands in a fiduciary capacity in relation to current or former members, and others entitled to pension benefits, while acting in the plan administrator capacity. [AEPPA s. 13(5)]

British Columbia

Under the British Columbia Pension Benefits Standards Act (BCPBSA), the pension plan administrator must act honestly, in good faith and in the best interests of current and former members, and other individuals to whom a fiduciary duty is owed, when exercising and performing its administrative powers and functions. The plan administrator must also exercise the same care, diligence and skill that a person of ordinary prudence would exercise when dealing with the property of another person. [BCPBSA s. 8(6)]

Manitoba

The Manitoba Pension Benefits Act (MPBA) requires the plan administrator to administer the pension plan, and invest and administer the pension fund with the same care, diligence and skill that a person of ordinary prudence would exercise in dealing with the property of another person. [MPBA proposed s. 28.1(2)] The plan administrator must invest and manage the assets of the pension fund in accordance with regulations. This must be accomplished in the same manner that a reasonable and prudent person would apply in investing and managing a portfolio of investments for a pension fund. [MPBA proposed s. 28.1(2.1)] If the plan administrator possesses certain skills that are relevant to the administration of a pension plan or pension fund, or ought to possess such skills, by reason of its business, profession or calling, these skills must be applied in the administration of the plan. [MPBA s. 28.1(3),(4)]

New Brunswick

The New Brunswick Pension Benefits Act (NBPBA) requires a pension plan administrator to exercise the same 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. The plan administrator must apply all relevant skills and knowledge that it possesses, or ought to possess, by virtue of its business, profession or calling, in the administration of the plan and in the administration and investment of the pension fund. [NBPBA s. 17(1),(2)]

Newfoundland and Labrador

The Newfoundland and Labrador Pension Benefits Act (NLPBA) requires the pension plan administrator to administer the pension plan and pension fund as a trustee for the employer, current and former plan members, and other persons with an entitlement under the plan. [NLPBA s. 14(1)]

Nova Scotia

The Nova Scotia Pension Benefits Act (NSPBA) requires that in administering or investing a pension fund, the plan administrator must apply the same care, diligence and skill that a person of ordinary prudence would exercise in dealing with the property of another person. The plan administrator must also apply all relevant knowledge and skills that it possesses, or ought to possess, by virtue of its profession, business or calling. [NSPBA s. 29(6)]

Ontario

Under the Ontario Pension Benefits Act (OPBA), a pension plan administrator must exercise the same care, diligence and skill in the administration and investment of the pension fund that a person of ordinary prudence would apply in dealing with the property of another person. [OPBA s. 22(1)] In addition, the plan administrator must use all relevant skills and knowledge that it possesses, or ought to possess, when administering the pension plan and fund, and when investing the pension fund, by reason of its business, calling or profession. [OPBA s. 22(2),(3)]

Prince Edward Island

The Prince Edward Island Pension Benefits Act (PEIPBA), which has not yet been proclaimed, requires that a pension plan administrator exercise the same care, diligence and skill in the administration and investment of the pension fund that a person of ordinary prudence would apply in dealing with the property of another person. [PEIPBA s. 28(1)] The plan administrator must also apply any relevant skills or knowledge that it possesses, or ought to possess, by reason of its profession, business or calling, when investing the fund and administering the plan and fund. [PEIPBA s. 28(6)]

Quebec

Under the Quebec Supplemental Pension Plans Act (QSPPA), a pension plan must be administered by a pension committee. The committee must apply the same prudence, diligence and skill that a reasonable person would exercise in similar circumstances. It must act with loyalty and honesty in the best interests of plan members and beneficiaries. The members of the pension committee must apply all relevant knowledge and skills that they possess, or ought to possess, by reason of their professions or businesses, when administering the plan. [QSPPA s. 151]

Saskatchewan

The Saskatchewan Pension Benefits Act (SPBA) states that while acting in the capacity of a plan administrator, the plan administrator has a fiduciary relationship to current and former plan members, as well as any other persons entitled to pension benefits pursuant to the plan. The plan administrator also holds in trust for these individuals, any fund that is established, or any contract that arises pursuant to the plan. [SPBA s. 11(2)(a),(b)] In this capacity, the plan administrator must act in good faith and in the best interests of current and former plan members, and any other persons entitled to benefits pursuant to the plan. The plan administrator must also be fair in respect to any competing legitimate interests. [SPBA s. 11(2)(c),(d)].

Investment (Federal PBSA & FIR)

Investment Approach

The plan administrator must invest the assets of the pension fund in accordance with the Pension Benefits Standards Regulations (PBSR) and in the same manner that a reasonable and prudent person would apply in respect of a portfolio of investments of a pension fund. [PBSA s. 8(4.1)]

Investment Objectives

The plan administrator must establish a written statement of investment policies and procedures in respect to the plan's portfolio of investments and loans. [PBSR s. 7.1(1)]

Quantitative Investment Limits

Federal investment rules contain a number of quantitative limits, including that the plan administrator may not lend or invest more than 10 per cent of the total book value of the plan's assets in any one person, two or more associated persons, or two or more affiliated corporations, subject to exceptions. [PBSR Schedule III s. 9]

Related Party of Non-Arm's Length Transactions and Conflicts of Interest

The plan administrator cannot lend the plan's money to a related party, invest the plan's money in the securities of a related party, or enter into a transaction with a related party on behalf of the plan. [PBSR Schedule III s.16]

Exception

The plan administrator may enter into a related party transaction if it is immaterial, or if it is required for the operation or administration of the plan, and the terms and conditions of the transaction are not less favourable than market terms and conditions. A plan administrator may invest the plan's money in the securities of a related party if those securities are acquired at a public exchange. [PBSR Schedule III s.17]