Pension Plan Governance and Risk Management: Best Practices in the New Era

Hosted by the British Columbia Regional Council

April 8, 2015

Pan Pacific Vancouver Hotel

Vancouver, BC
FICOM Risk-Based Regulation and Pension Plan Governance

Abraham Koomson
Director of Pensions
Financial Institutions Commission
News Flash!!!!!!

COMING SOON

NEW BC PENSION REGULATION
Introduction

- When pension plans fail to deliver on their pension promise, poor governance is often the root cause.
  - (JEPPS Report: Pension Reform in Alberta and British Columbia)

- Success without governance is often called “chance” and unquestionably, chance is not a successful business model.
  - (ProteusPerformance.com)
Pension Benefits Standards Act (PBSA)

- Section 42

- (1) The Administrator of a pension plan must ensure that a written governance policy that meets the prescribed criteria is established in respect of the structures and processes for overseeing, managing and administering the plan.

- (2) The administrator of a pension plan must ensure that the plan is administered in accordance with the governance policy established under subsection (1).
Risk-Based Regulation

What is Risk-Based regulation:

Systematized decision making frameworks and procedures to prioritize regulatory activities and deploy resources, principally relating to inspection and enforcement, based on the assessment of the risks that regulated entities pose to the **regulators objectives**

(OECD: source)
Key Points of Definition

- Systematized decision making
- Prioritize regulatory activities
- Assessment of risk
- Regulators objectives
Pension Regulators objective

- Work within the legislative framework to create an environment that will increase the **probability** that pension benefits promised will be paid.

- Work with administrators to identify risks that may affect the security of member benefits.
Risk-Based Framework

• Understand mandate

• Understand and identify the pension risks

• Prioritize pension risks

• Work with administrators to manage risks

• Appropriate/timely regulatory response

• Monitor impact of response.
Our Goal

• Encourage administrators to think of:
  • What could go wrong
  • Not
  • What went wrong
• We have to think beyond meeting minimum standards
OSFI’s Early Intervention Mandate

• Mid-1990s Collapse of Life Insurance Companies:

• Anticipate problems early

• Intervene early to minimize impact.

• Early warning indicators/triggers
FICOM’s Risk-Based Framework

- Early Warning Indicators: Building a risk profile – Stage I
  - Funding Risk
    - Current funding level
    - GC funding assumptions
    - Solvency position
  - Investment Risk
    - Fund performance
    - Investment policy/objectives
    - Plan demographics
    - Segment comparison
Stage II Assessment

• Pension Plan governance
  • Documentation
  • Controls/Oversight
  • Monitoring

• Employer Covenant
  • Financial strength
  • Industry
Governance requirements

• Governance policy must do the following:
  • Set out the structures and processes for overseeing, managing and administering the plan;
  • Explain what the structures and processes are intended to achieve;
  • Identify roles, responsibilities and accountabilities
  • Establish performance measures and monitoring process
  • Identify material risks that apply to the plan
  • Establish internal controls to manage them
FICOM’s Governance Assessment

• Does the administrator understand the plan’s risk?

• Can the administrator demonstrate that they are effectively managing the risks?

• Can the administrator provide documentation of their monitoring activities?

• Roy will talk about what tools may be used to demonstrate effective governance to the regulator.

• As regulators we are open to your suggestions.
Outcome:

• Determine “Net Risk” of plan based on our Stage II Assessments

• Modify risk assessment if necessary

• Recommend regulatory response to Superintendent.

• Both OSFI and FSCO undertake semi-annual solvency projections as part of their risk assessment

• FICOM intends to incorporate this assessment when we complete the 2014 risk assessments.
Next Steps

• Develop baseline for initial governance assessment:
  • Administrator self-assessment

• Develop Best Practices Guideline in consultation with industry stakeholders.
THANK YOU

Success without governance is called “chance” and unquestionably,
Chance is not a successful business model.
A Lawyer’s Guide to Pension Governance and Risk Management

Kenneth Burns
Partner
Lawson Lundell LLP
Lawyer’s Perspective: Start with the Governing Law

– Start with the new PBSA
– What does the new PBSA require you to do? Are you doing it? Are you keeping track?
– What does the new PBSA prohibit you from doing?

Next, same questions for other sources of law and standards
– Income Tax Act, CAPSA Guidelines and now ... Risk Based Framework

Next, same questions for Plan documents – plan text, governance and funding policies etc.
New plan structure definitions

The New PBSA divides plans into several potentially overlapping structures:

- Single employer plans (SEPs)
- Multi employer plans (MEPs)
  - Collectively bargained MEP (CBMEPs)
  - Non-collectively bargained MEP (NCBMEPs)
- Negotiated cost plans (NCPs)
- Divisional multi-employer plans (DMEPs)
- Jointly sponsored plans (JSPs)
Overlapping Plan Structures

- Single Employer Plan (SEP)
- Collectively Bargained Multi-Employer Plan (CBMEP)
- Non-Collectively Bargained Multi-Employer Plan (NCBMEP)
- Divisional Multi-Employer Plan (DMEP)
- Jointly Sponsored Plan (JSP)

Negotiated Cost Plan
Benefit Provisions & Components

The New PBSA also divides benefits into several different kinds of provisions?

– Benefit Formula Provisions
  • Defined Benefit
  • Target Benefit

What “benefit components” are in your plan? Do you want to change?
Structure & Benefit Combinations

– 14 Possible Structure Combinations
– 7 Possible Benefit Combinations
– 19 Excluded Combinations

  = 79 Varieties of Plan

– Not including “public sector plans”, “publically funded plans” and “supplemental pension plans”
The New Governance Rules

– Every Plan must have two or three formal policy documents:
  1. Governance Policy (all plans)
  2. Funding Policy (if plan has benefit formula provisions)
  3. Statement of Investment Policies and Procedures (all plans)

– And of course, must still have:
  4. Plan text
  5. Plan summary
New Documents to draft and track – Governance Policy

Prescribed Criteria

– Describe structures
– Describe processes for administering plan and their obligations
– Identify decision makers and their roles and accountabilities
– Set performance measures and monitoring process for the above
– Code of Conduct and Conflict of Interest policy
– Identify education and skills needs
– Identify risks and internal controls
– Establish dispute resolution processes
New Documents to draft and track – Funding Policy

Prescribed Criteria

– Set out funding objectives re: benefit security, benefit levels, stability of contributions
– Identify risks, risk tolerance and internal controls
– Set out funding ratio targets
– Deal with amortization of deficits
– Address reduction of benefits (if applicable)
– Policy on surplus
– Policy on actuarial reports
Compliance Risk Hierarchy

1. Risk of not meeting legislative minimum standards
2. Risk of not meeting common law minimum standards
3. Risk of not meeting guideline based best practices standards
1. Documenting applicable standards

2. Tracking compliance with standards
   2.1 Binary Compliance (Yes/No)
   2.2 Nuanced Compliance (Best efforts; Best Knowledge etc.)
   2.3 Action on Non-compliance

3. Weighing Legal Risks arising from non-compliance:
   3.1 Bad Outcomes – Shortcomings in communication and delivery - systemic and anecdotal
   3.2 Regulatory Action
   3.3 Litigation Trends – likelihood of being sued

4. Dynamic Governance – developing systems practices that avoid bad outcomes, integrate compliance and control costs
The New Plan Assessment Rules

– Every Plan must have a Plan Assessment done at least every 3 years
  • Ensure compliance with Act and Regulations/governance documents
  • Funding/investment
  • Performance of trustees, administrative staff and agents
  • Must be in writing and available for Superintendent on request

– ‘If the new Act didn’t require this, we would need to invent it’
Annual/Triennial Plan Assessment – Other Considerations

– Plan governance now integral to PBSA
  • Failure to comply is a breach
– Alberta and BC originally wanted assessments to be annual
– But process may be difficult and time consuming for same sponsors
– Our view: annual tracking meets a higher standard, provide better and timelier results
– Consider preparing annual plan assessments anyway
Annual/Triennial Plan Assessment
Compliance Tracking Elements

- Regulators require testing the plan against
  - Act
  - Regulations
  - Governance Policy
  - Funding Policy
  - Statement of Investment Policies and Procedures
  - Performance of Trustees
  - Performance of staff and agents
Annual/Triennial Plan Assessment

– Also consider testing against
  • Plan text
  • Forms of Statements
  • Plan Booklet
  • Participation Agreements
  • Trust agreement or insured funding contracts
  • CAPSA Guidelines
  • Any internal and Risk Guidelines maintained by Sponsor
  • FICOM Risk Based Regulatory Framework standards
Using FICOM Risk Framework as an Internal Control

– The Framework is designed to alert regulators of risks requiring regulatory attention
– If it warrants regulator attention, it warrants sponsor attention sooner
– Sponsors and administrators should consider assessing plan risks using same criteria
– Internal assessment using Framework factors acts as an early warning system – allows you to fix risk factors before FICOM reviews plan
Plan Assessments: Confidentiality and Privilege

- Do not need to be filed with FICOM, but must be provided on request
- No requirement to show to plan members, participating employers, unions or litigants
- Consider involving legal counsel in order to attach solicitor-client privilege to sensitive aspects of assessment
- Goal is to identify problems so they can be fixed – need confidentiality to avoid leading your enemies to your door
THANK YOU
Risk-Based Pension Plan Governance

Roy Stuart
Aon Hewitt
Ficom’s Risk-Based Framework

- We are fully supportive of the focus on risk and the dynamic, situational approach FICOM is taking
- The three-part model of (1) risk assessment, (2) risk response and (3) risk monitoring, is very familiar to us
- We agree, too, with FICOM’s observations regarding cadence, where the frequency and the strength of the risk management activities are linked to an assessment of both the impact and the probability of the risks being managed
- The more you concentrate on key metrics and their management, the more effective your governance program can be
Ficom’s Risk-Based Framework (cont’d)

• FICOM’s approach is an excellent template that can readily be adapted to other plans and other risks
  • It deals with DB/TB only; obviously not DC
  • It sees main “strategic” risk from a regulator’s perspective, that is, the risk of benefits not being paid
• We think of the risk of benefits not being paid is a key risk, obviously, but it is one of a number of important risk categories that need to be accounted for in an effective governance program
• So, I would like to expand the discussion a little to include other risks and other plan types
Identifying the Risks

• There are numerous possible variations on the numbers and names of the key risk buckets, but we often think in terms of four risk categories:
  • Strategic – the suitability of the plan design and its ability to support HR/Business objectives
  • Financial – the adequacy of the plan’s assets, contribution stability and affordability; delivery costs
  • Operational - service quality
  • Regulatory/legal – compliance with law and policies
Identifying the Risks (cont’d)

• You need to be attentive to all of these risks, but practically speaking you want to concentrate your focus in the most important risks with respect to your own plan(s)

• The most important risk element can differ very significantly among plans, e.g.,
  • DB versus DC
  • Single versus multi-employer
  • Jointly cost-shared
  • In-house versus third party administration

• Often, a critical component of effective risk management is building succinct and apt metrics and communications that deliver timely, accurate and relevant information to key decision makers in the governance process
Risk Management – Two Practical Illustrations

• We will look first at a DC plan and later at a DB plan, showing how key risks are:
  • Articulated
  • Measured/monitored; and
  • Communicated
DC Risk Management

- Our plan governors are focusing on three key risks:

  - **Legal / Fiduciary Risks**: Risk of lawsuits arising from selection of inappropriate service providers, investment losses, high fees, equity concentration
  - **Competitive Risks**: Inability to attract / retain key roles in a competitive labour environment
  - **Retirement Risks**: Inability to manage orderly transition of employees into retirement (because employees can’t afford to retire)
DC Risk Management

Design
• Investment Structure Design
• Objective Setting
• DC Plan Design
• Benchmarking
• Employee Research

Delivery
• Record Keeping
• Financial Planning
• Investment Education

Implementation
• Record Keeper Selection/Transition
• Investment Options Development/Transition
• Default Strategy
• Plan Documentation/Contracts
  • Employee Communications

Monitoring
• Record Keeper
• Investment Structure
• Investment Managers
• Investment Options
• CAP Compliance
• Member Analysis
  — Participation
  — Investing
  — Income Adequacy

Legal / Fiduciary Risks
Competitive Risks
Retirement Risks
Member analysis – What Is It?

Member Analysis

- Participation—In/out; wait to join, default rates, year-over-year changes; benchmarking
- Savings—Savings rates, match optimization, year-over-year changes; benchmarking
- Investing—Equity exposure, returns, account balances, investment options, default rates, benchmarking
- Income Adequacy—Projected income (versus targets), sensitivities, benchmarking
### Retirement Income Replacement Analysis

#### Business Unit
- **IRI 1**
- **IRI 2**
- **IRI 3**
- **IRI 4**
- **IRI 5**
- **IRI 6**
- **IRI 7**
- **IRI 8**
- **IRI 9**

#### Retirement Program
- **DB**
- **DC**
- **DBOC**
- **Other**

#### Assumptions
- Retirement Age: 65
- Investment Return: 6.53%
- Discount Rate: 4.33%
- Salary Increases: 3.05%
- Average Industrial Wage: 2.53%
- Government Benefits?: CP and QAS
- Savings Rate: Actual

#### Hot Zone Analyzer

- **Row 1**: Count
- **Row 2**: Projected Service
- **Row 3**: Current Pay
- **Row 4**: Savings Rate
- **Row 5**: Income Replacement Ratio

#### Continuous Service

<table>
<thead>
<tr>
<th>Age</th>
<th>Under 5</th>
<th>5 - 9</th>
<th>10 - 14</th>
<th>15 - 19</th>
<th>20 - 24</th>
<th>25 - 29</th>
<th>30 - 34</th>
<th>35+</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under 25</td>
<td>42.3%</td>
<td>45.3%</td>
<td>65.6%</td>
<td>74%</td>
<td>42.3%</td>
<td>$45,357</td>
<td>2.6%</td>
<td>74%</td>
<td></td>
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<tr>
<td>25 – 29</td>
<td>39.2%</td>
<td>42.3%</td>
<td>61.29%</td>
<td>6.0%</td>
<td>79%</td>
<td>$59,628</td>
<td>4.5%</td>
<td>6.0%</td>
<td>79%</td>
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<tr>
<td>30 – 34</td>
<td>201%</td>
<td>38.3%</td>
<td>91.0%</td>
<td>11%</td>
<td>50%</td>
<td>$70,627</td>
<td>4.4%</td>
<td>4.3%</td>
<td>71.5%</td>
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<tr>
<td>35 – 39</td>
<td>167%</td>
<td>30.5%</td>
<td>48.4%</td>
<td>34.3%</td>
<td>42.5%</td>
<td>$74,619</td>
<td>4.4%</td>
<td>6.0%</td>
<td>61%</td>
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<tr>
<td>40 – 44</td>
<td>25.8%</td>
<td>30.5%</td>
<td>31.78%</td>
<td>6.4%</td>
<td>6.4%</td>
<td>$75,677</td>
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<td>52%</td>
<td>6.4%</td>
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<tr>
<td>45 – 49</td>
<td>21.4%</td>
<td>25.8%</td>
<td>31.78%</td>
<td>25.8%</td>
<td>25.8%</td>
<td>$80,984</td>
<td>4.6%</td>
<td>4.6%</td>
<td>4.6%</td>
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<td>50 – 54</td>
<td>16.1%</td>
<td>19.8%</td>
<td>30.9%</td>
<td>30.9%</td>
<td>30.9%</td>
<td>$62,094</td>
<td>4.6%</td>
<td>4.6%</td>
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<tr>
<td>55 – 59</td>
<td>11.6%</td>
<td>15.1%</td>
<td>15.1%</td>
<td>15.1%</td>
<td>15.1%</td>
<td>$56,067</td>
<td>4.6%</td>
<td>4.6%</td>
<td>4.6%</td>
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<td>60 – 64</td>
<td>8.8%</td>
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<td>14.1%</td>
<td>14.1%</td>
<td>14.1%</td>
<td>$57,452</td>
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<td>65+</td>
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<td>8.5%</td>
<td>11.4%</td>
<td>11.4%</td>
<td>11.4%</td>
<td>$30.3</td>
<td>5.0%</td>
<td>5.0%</td>
<td>5.0%</td>
</tr>
</tbody>
</table>

#### Income Replacement Ratio

- **Row 1**: 81 employees currently age 40 to 44 with 10 -14 years of service
- **Row 2**: This group is projected to have 34.3 years of service at age 65
- **Row 3**: Current pay averages $92,546
- **Row 4**: Savings rate averages 6.4% of pay
- **Row 5**: Projected pay replacement based on current savings rates and reflecting government benefit is 62% at age 65
Putting the Information to Work

• Analysis serves dual purposes:
  • Communicate with Management / Pension Committee about retirement risk (i.e., risk that employees won’t be able to afford to retire)
  • Can use underlying data / analysis to “push” gap statements to members (showing projected income replacement, gap relative to a target, and impact of changes to savings/investments)

• Start with baseline case / assumptions and look at sensitivity to changes in savings rates, investment returns, and other assumptions

• If there is a problem, consider different interventions to get employees on tract:
  • Plan design changes
  • Investment structure changes
  • Communication / education
Best Estimate Status

Commentary

- The Q4 2013 and Q1/Q2 2014 are consistent from previous dashboards.
- The Q3 2014 results are based entirely on the December 31, 2013 valuation.
- The best estimate liabilities as at December 31, 2013 were $4,754.9 million.
- The best estimate current service cost as at December 31, 2013 was 11.62% of pensionable earnings.
- The best estimate discount rate dropped from 7.10% per annum to 6.97% per annum as at September 30, 2014, which reflects current long-term market expectations.
- As a result of the updated discount rate, the current service cost increased from 11.62% of pay to 12.00% of pay.
Q3

Asset-Liability Return

Assets gained 1.5% during the quarter while liabilities gained 4.7%.

These factors, combined with contributions during the quarter, contributed to a funded status decrease of 2.7%.

<table>
<thead>
<tr>
<th>Market Value of Assets</th>
<th>2013 Q4</th>
<th>2014 Q1</th>
<th>2014 Q2</th>
<th>2014 Q3</th>
<th>YTD¹</th>
<th>TTM²</th>
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<tbody>
<tr>
<td></td>
<td>6.1%</td>
<td>3.8%</td>
<td>2.9%</td>
<td>1.5%</td>
<td>8.4%</td>
<td>15.1%</td>
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</table>

<table>
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<tr>
<th>Best Estimate Liabilities</th>
<th>2013 Q4</th>
<th>2014 Q1</th>
<th>2014 Q2</th>
<th>2014 Q3</th>
<th>YTD¹</th>
<th>TTM²</th>
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<tr>
<td></td>
<td>1.8%</td>
<td>1.8%</td>
<td>1.8%</td>
<td>4.7%</td>
<td>8.4%</td>
<td>10.4%</td>
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<table>
<thead>
<tr>
<th>BE Funded Ratio Change</th>
<th>2013 Q4</th>
<th>2014 Q1</th>
<th>2014 Q2</th>
<th>2014 Q3</th>
<th>YTD¹</th>
<th>TTM²</th>
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<tbody>
<tr>
<td></td>
<td>4.7%</td>
<td>2.8%</td>
<td>1.8%</td>
<td>-2.7%</td>
<td>1.7%</td>
<td>6.4%</td>
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</tbody>
</table>

¹ Year-to-Date
² Trailing Twelve Months
³ The asset return on the Market Value of Assets is calculated as: \(2 \times \frac{(I - E)}{[L_0 + A_1 - (I - E)]}\)
⁴ The liability return on the Best Estimate Liabilities is calculated as: \(2 \times \frac{(L_1, L_0 - CSC - BP)}{[L_0 + L_1 - (L_1, L_0 - CSC - BP)]}\)
Commentary

- The actuarial value of assets is equal to the market value of assets effective December 31, 2013.

Historical Funding Rate
(% of Pay)

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<td>12.7%</td>
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<td>16.5%</td>
<td>17.3%</td>
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## Policy

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<th>Report/Activity</th>
<th>Frequency</th>
<th>Delivered to</th>
<th>Reviews</th>
<th>Prepares/Monitors</th>
<th>Advises</th>
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<td><strong>Governance</strong></td>
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<td>Governance Structure Review</td>
<td>3–5 years</td>
<td>Board of Directors</td>
<td>Retirement Committee</td>
<td>HR/Finance</td>
<td>External Providers</td>
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<tr>
<td>- Allocation of roles &amp; delegation</td>
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<td>- Terms of reference</td>
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<tr>
<td>- Plan mission</td>
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<td>Annual governance assessment</td>
<td>Annually</td>
<td>Retirement Committee</td>
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<td>External Providers</td>
<td>HR/Finance</td>
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<td>Annual Report (Cf. Committee terms of reference)</td>
<td>Annually</td>
<td>Board of Directors</td>
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<td>HR/Finance</td>
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<td>- Compliance with internal policies, applicable legislation and regulations</td>
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<tr>
<td>- DB: Asset mix</td>
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<td></td>
<td></td>
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<tr>
<td>- Performance of total fund and asset classes</td>
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<tr>
<td>- Most recent actuarial valuation</td>
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<td>- DC: Asset allocation</td>
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<tr>
<td>- Performance of investment options</td>
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<td>Governance Self-Assessment</td>
<td>Annually</td>
<td>Retirement Committee</td>
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<td>HR/Finance</td>
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<td>Review of Fiduciary Education Practices</td>
<td>3 years</td>
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<td>HR/Finance</td>
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<td>Review of member communications and investment education policy and procedures (DC)</td>
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<td>HR</td>
<td>External Providers</td>
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<td>Review plan design</td>
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<td>Retirement Committee</td>
<td>HR/Finance</td>
<td>External Providers</td>
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<td><strong>Investments</strong></td>
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<td>Review content and approve SIP&amp;P</td>
<td>Annually</td>
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<td>Retirement Committee</td>
<td>Finance</td>
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<td>Risk study (DB)</td>
<td>3–5 years</td>
<td>Board of Directors</td>
<td>Retirement Committee</td>
<td>Finance/External Provider</td>
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<td>Investment Report</td>
<td>Quarterly</td>
<td>Retirement Committee</td>
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<td>Finance</td>
<td>External Providers</td>
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<td>- Investment performance</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>- Allocation among asset classes</td>
<td></td>
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<tr>
<td>- Compliance with investment policies</td>
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</tbody>
</table>
## Performance Management

<table>
<thead>
<tr>
<th>Party</th>
<th>Reviewer</th>
<th>Frequency</th>
<th>Key Performance Indicators</th>
<th>Date of Most Recent Review</th>
<th>Commentary</th>
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<tbody>
<tr>
<td>Retirement Committee</td>
<td>Self-Assessment, delivered to Board of Directors</td>
<td>Annually</td>
<td>• Committee effectiveness, as measured by self-assessment</td>
<td></td>
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</tr>
<tr>
<td>HR Department</td>
<td>VP HR, with input from Retirement Committee</td>
<td>Annually</td>
<td>• Plan member satisfaction survey results</td>
<td></td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>• Support given committee</td>
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<tr>
<td>Finance Department</td>
<td>CFO, with input form Retirement committee</td>
<td>Annually</td>
<td>• Support given committee</td>
<td></td>
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<tr>
<td>Actuary</td>
<td>Retirement Committee, with input from Finance and HR</td>
<td>Annually</td>
<td>• Accuracy</td>
<td></td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>• Timeliness</td>
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<td></td>
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<td>• Fees</td>
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<td></td>
<td></td>
<td></td>
<td>• Contribution to committee meetings</td>
<td></td>
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</tr>
<tr>
<td>Record Keeper</td>
<td>Retirement committee with input from HR</td>
<td>Annually</td>
<td>• Service quality metrics in service agreement</td>
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<td></td>
<td></td>
<td></td>
<td>• Support given committee</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>• Fees</td>
<td></td>
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<tr>
<td>Investment Consultant</td>
<td>Retirement Committee with input from Finance</td>
<td>Annually</td>
<td>• Clarity, usefulness of quarterly reports</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>• Fees</td>
<td></td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>• Contribution to committee meetings</td>
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</tbody>
</table>
2015 ACPM
NATIONAL CONFERENCE

DELTA GRAND OKANAGAN
Kelowna, B.C.
September 15-17 2015

CULTIVATING
RETIREMENT
INCOME SOLUTIONS

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