



**ACPM
SUBMISSION TO
CANADIAN ASSOCIATION OF PENSION
SUPERVISORY AUTHORITIES
CAPSA**

**CONSULTATION PAPER:
THE PRUDENCE STANDARD AND THE ROLES OF THE PLAN
SPONSOR AND PLAN ADMINISTRATOR IN PENSION PLAN
FUNDING AND INVESTMENT**

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FOREWORD

The Association of Canadian Pension Management (ACPM)

The Association of Canadian Pension Management (ACPM) is the informed voice of Canadian pension plan sponsors, administrators and their allied service providers. Established in 1976, the ACPM advocates for an effective and sustainable Canadian retirement income system through a non-profit organization supported by a growing membership and a team of volunteer experts. Our members are drawn from all aspects of the industry from one side of this country to the other. We represent over 300 pension plans consisting of more than 3 million plan members, with total assets under management in excess of \$300 billion.

The ACPM promotes its vision for the development of a world-leading retirement income system in Canada by championing the following Guiding Principles:

- Clarity in legislation, regulations and retirement income arrangements;
- Balanced consideration of other stakeholders' interests; and
- Excellence in governance and administration

Introduction

The ACPM appreciates the opportunity to provide our input to the CAPSA consultation paper entitled The Prudence Standard and Roles of the Plan Sponsor and Plan Administrator in Pension Plan Funding and Investment. In this Brief you will find our perspective on the key points raised for discussion in this paper. Following review of our comments, should you have any questions or wish to carry on further dialogue about its content, we would welcome the opportunity to do so.

General Comments

The ACPM believes that the consultation paper represents a good initiative in furthering the description of governance best practices, particularly as they relate to the funding of pension plans.

We agree with the paper that it is Plan Sponsors that are responsible for drafting Funding Policies (though we would like this made more clear in pension legislation) and that their development will be aligned with the objectives of the sponsor or the owners of the sponsor, which may conflict with those of plan beneficiaries. While the development and adoption of a Funding Policy may represent a governance best practice, we note that it is currently not a legislative requirement in any Canadian jurisdiction and suggest that the Funding Policy guideline that is developed following the consultation process recognize this fact explicitly.

Similarly, we agree that plan Administrators have a legal responsibility to develop and implement an Investment Policy. In this role, the Administrator has a fiduciary duty to act in the best interests of all plan beneficiaries. As noted above, the objectives of the Plan Sponsor in developing the Funding Policy may conflict with the objectives of the Administrator in developing the Investment Policy. We encourage CAPSA to consider developing an appropriate conflict resolution mechanism to assist Plan Sponsors and Administrators in resolving such conflicts.

We agree that it is a good idea for CAPSA to develop separate guidelines addressing funding policies and investment policies. We also believe that CAPSA should explicitly address the different needs and requirements for Defined Contribution Pension Plans as distinct from Defined Benefit Pension Plans and for Single Employer Pension Plans (SEPPs) and Multi-Employer Pension Plans (MEPPs), either within each of these guidelines or by creating separate guidelines for these very different types of plans. In particular, we note that if a plan sponsor has developed a retirement income target for a Defined Contribution Pension Plan, then the Funding Policy should require that the target be reviewed periodically.

There were no questions relating to the prudence standard, however we would note three comments in particular:

- 1) in a MEPP when a union or any other party appoints a trustee, it should be made clear that the trustee must act in the best interests of all plan beneficiaries, not just one stakeholder (in particular the stakeholder that appointed him or her);
- 2) the fiduciary duty of the Administrator and the self-interest of the employer are not always in conflict; and
- 3) not all service providers automatically become “agents” of the Plan Sponsor or Administrator. It depends on the nature of their mandate. For example, a consultant whose mandate is limited to providing ideas to the Plan Sponsor and whose fees are not paid from the plan would not become an agent of the Plan Sponsor as a result of this mandate.

The wording of any subsequent CAPSA publications on funding and investment policies should acknowledge these points.

Question #1:

What role should the plan administrator play regarding the funding policy?

We believe that the Administrator should play three key roles with respect to the Funding Policy – initiate, communicate, and monitor. We expand on this comment below.

Initiate: The Administrator role here should be to encourage the Plan Sponsor to develop a Funding Policy and collaborate with the Plan Sponsor in its development, if requested. We note that in a Multi-Employer Pension Plan, the Administrator’s role may extend to developing the Funding Policy.

Communicate: In accordance with any direction provided by the Plan Sponsor, the Administrator should communicate the specifics of the Funding Policy to plan beneficiaries and appropriate external service providers that have been engaged by the Administrator. This communication could be made in conjunction with the communication of the Investment Policy. In particular, it could highlight any material inconsistencies between the two policies.

Monitor: The plan Administrator currently has a legislative obligation to monitor that at least statutory minimum contributions are remitted to the pension fund. If they are not, the Administrator has an obligation to report any shortfall to the pension supervisory authority. We contrast this with the Administrator’s monitoring responsibilities with respect to the Funding Policy. To the extent that the Plan Sponsor remits contributions that are at least equal to statutory minimum contributions, but less than the policy level of contributions specified in the Funding Policy, this shortfall should be reported to the Plan Sponsor for resolution.

Question #2:

Are the elements for the funding policy set out in this paper sufficient? If not are there some additional elements you would recommend?

When CAPSA develops its final guideline for Funding Policies, we believe that it will be important to make clear explicitly that while the development and adoption of a Funding Policy represents a best practice of good governance, there is currently no legislative requirement to do so.

CAPSA should recognize that there are differences in resources among various Plan Sponsors. The effort that Plan Sponsors expend in developing a Funding Policy will need to be gradual if it is not to devolve into a “tick the box” exercise.

Many Plan Sponsors would find a Q&A forum of benefit as they draft their initial Funding Policy. The approach that CAPSA recently implemented to help Plan Sponsors interpret the CAP Guidelines would be a good model to follow.

We believe that both the Funding Policy and Investment Policy documents should describe the process that will be used to resolve any conflicts between the two documents. Such conflicts would most likely arise from a difference in “attitude to risk” between the Plan Sponsor and the Administrator.

Finally, we believe that both Plan Sponsors and Administrators would find it useful if there were at least a high level description of the suggested process to develop a Funding Policy.

The Regulator may also find it useful to confirm whether this review process has occurred by adding a question on the Annual Information Return, similar to the question that currently exists asking whether the Funding Policy has been reviewed.

Question #3:

What role should the plan sponsor play regarding the Statement of Investment Policy and Procedures (SIP&P)?

We believe that the Plan Sponsor should have the following roles regarding the development of the SIP&P:

- Advise the Administrator of the contents of the Funding Policy;
- Advise the Administrator of the Plan Sponsor's Benefit Policy (i.e., intended benefits, not just the contractually committed benefits);
- Advise the Administrator of the Plan Sponsor's "attitude to risk";
- Collaborate with the Administrator to work toward consistency between the Funding Policy and the SIP&P; and
- Engage actively with the Administrator on an ongoing basis to review both the Funding Policy and the SIP&P, and to implement amendments to each document.

In some circumstances, the Plan Sponsor may actually assume a much larger role in relation to the SIP&P. The Plan Sponsor is responsible for plan design. If, for example, the Plan Sponsor decides to have a CAP with 3 investment options, then it has limited the administrator's authority and role in relation to the SIP&P. Similarly, if a DC plan is designed with a single investment option, that too will greatly circumscribe the Administrator's responsibilities.

We observe that there is a multitude of governance arrangements and related documentation affecting the operation of different pension plans. As a result, we encourage CAPSA not to be prescriptive in its statements regarding the development of either the Funding Policy or the SIP&P. Rather; we repeat our suggestion that CAPSA consider establishing an appropriate conflict resolution mechanism to assist Plan Sponsors and Administrators in discharging their duties if conflicts arise.

Question #4

Under what circumstances should the plan administrator be encouraged to have an investment policy covered by more than one document?

To a certain extent, the degree of detail required of an investment policy is affected by the complexity of plan arrangements. We do not believe that there is a need for CAPSA to encourage (or discourage) multiple documents. Rather, we believe that CAPSA should specify the types of issues where documentation would be useful, such as:

- Investment beliefs;
- Detailed provisions of mandates for individual managers within a multi-manager structure; and
- Contractual arrangements with investment managers and custodians.

CAPSA should then leave it to the Administrator to decide on the most appropriate approach to documentation given their specific circumstances. Although, CAPSA may want to state that it is the Administrator's obligation to ensure that all such documents are consistent.

Question #5

Does the paper adequately address what additional elements could be incorporated into the SIP&P?

The ACPM believes that the current federal guidelines for the development of SIP&Ps have operated reasonably well. There are, however, certain areas that could benefit from being updated to reflect current situations. Two examples are the use of leverage techniques by pension funds and guidelines on the types and amounts of collateral for securities lending. The ACPM would welcome the opportunity to work with CAPSA for an in depth review of the guidelines.

Question #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?

All of the items listed are helpful in determining what the Administrator should consider when designing a prudent investment process. But to have to do this for each and every investment, as the paper implies, is (a) very expensive and not practical, and (b) inconsistent with the notion of prudence for the investment portfolio overall, which suggests that individual investment decisions do not all have to be judged the same way. It would be helpful if the description of the examination process recognized an Administrator's ability to design a process that would apply to a series or portfolio of investments, rather than each and every investment transaction. It would also be helpful if CAPSA could recognize explicitly that it is permissible for the Administrator to delegate responsibility for certain aspects of prudence (e.g., if the Administrator has given an investment manager responsibility for a portfolio, the Administrator should be able to say that the manager is responsible for ensuring the prudent investment of that portfolio).

As the regulators conduct their examinations, it will be very important to distinguish between items that are required to ensure statutory compliance and items that would be considered best practices, but not specifically required by legislation.

On a more detailed level, we have some additional comments.

- The lead-in starts with the words: "When the regulator examines the plan administrator's funding and investment activities ..." It is not clear what funding activities the Administrator has. We believe that funding activities are primarily conducted by the Plan Sponsor, but this should be made clearer in legislation and in regulatory policies.
- Similarly, one of the activities is that the regulator "Determines whether a funding policy has been considered or adopted." Since the regulator is examining the Administrator and not the Plan Sponsor, this may not be possible.

- Also, later on the regulator is meant to contemplate to what extent funding [...] documents are being reviewed, updated and followed. This does not seem to be an appropriate activity for an audit of the Administrator, particularly in an environment where funding policies are not required by legislation.

Once again we thank CAPSA for their efforts with regard to presenting this paper and seeking consultation from the industry. We welcome the opportunity to provide further comments as the need arises.