pensions
backgrounder #10

Pension Plan Governance

Part 10 in a Series

The full series of pension backgrounders are contained in the National Union's Pensions Manual, Fourth Edition—available from the National Office

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BACKGROUNDER #10

Pension Plan Governance

Traditionally, pension funds and plans were assumed to be the responsibility of employers. The prevalent view was that employers had the sole prerogative to manage our pension plans as they saw fit, with the responsibility to provide their workers with the pension promise – secure income during their retirement years. Workers and their unions rarely questioned how the pension plan was being administered, or the decisions plan managers made on fund investment. Their focus was on the actual amount of the pension benefit on retirement. In the public sector, most plans were partially funded and really didn't accumulate a significant investment fund; in fact some plans didn't even have an investment fund established – there was no need for a fund, per se, because the benefits were guaranteed, and there would always be a government with taxing power in place to ensure the benefits promised were actually paid.

In the last two decades there has been a huge shift in the level of interest and attention workers and their unions give to pension plans. They're not only thinking about the level of pension benefits; they're also paying much more attention to the overall health of pension plans. Pensions are now widely viewed by workers as their deferred wages that will provide them with a steady income upon retirement.

For this reason, the National Union and its Components have long had a concern with the specific ways our members' pension plans are governed – in particular, the way they are structured, and how their governing bodies are constituted.

••• What is Pension Plan Governance?

Pension plan governance refers to the system used to organize the roles and responsibilities of all individuals involved in governing, managing and administrating a pension plan.

The governing structure of a pension plan will determine such things as:

• the benefits provided by the pension plan to its members;

• the allocation of contribution rates among employers and employees;

• the investment policy of the plan and how it is executed;

• the delivery of the benefits to plan members (i.e. pension administration);

• the selection of the professional advisors to the pension plan (i.e. actuary, legal, audit, investment); and / or

• the best way of communicating with plan members, on an ongoing basis in relation to results, problems and other issues.

The governance factors relevant to any particular situation can vary according to the specific model that a plan has adopted.

••• Governance Models

Governance models for pension plans can be looked upon as a continuum; movement along the continuum depicts the extent to which authority over the critical governance factors passes from control by the employer sponsor, at one end, to control by plan members, at the other.

Before exploring the types of governance models, a number of important factors should be recognized. First, pension plans are subject to federal and provincial regulation in many of the critical governance areas such as benefits, design, investments and funding strategy. These regulations determine the degree of control the governance authority exercises over the pension plan.

Second, a model may not indicate the control that is actually exercised. For example, in some cases, decision-making authority rests with the employer, the plan sponsor, but the employer has established an advisory body which includes representatives of plan members (workers). Often, the employer will regularly implement the recommendations of the advisory body.

There are other cases where workers have formal representation on a pension board, but are outnumbered by employer representatives. In still other instances, they may only have decision-making authority over a limited range of issues.

A brief exploration of the four main governance models should illustrate some of these factors.

••• Employer Governance

In this model, authority over the critical governance factors rests with the sponsor of the plan – the employer. Day-to-day management of the pension plan, for private sector plans, rests with an appointed trustee (for example, the employer's own administrative operations, a trust company, a life insurance company, or specified individuals appointed by the employer).

For some public sector plans, where pension plan governance is based on what is included in the relevant legislation governing a particular plan, it may rest within one government ministry, or be distributed among several.

Under this model, the terms of the pension plan are typically not negotiable, although there may be consultations on specific issues.

Some employers / sponsors have modified this model by appointing pension committees or advisory bodies. The mandate of such committees or bodies can vary. With some plans, it may have no role except to advise, in relation to a limited range of issues. In other plans, it can have a number of specific responsibilities, which (in the public sector) may even be legislated.

••• Member Governance

In this model, authority over the critical governance factors rests with the sponsor of the plan – the union which appoints a Board of Trustees that is made up entirely of plan member representatives. The employer's contribution to the plan is defined through collective bargaining, and the employer has no residual financial obligations beyond this.

In this model, the Board of Trustees is responsible for plan administration, controlling the investment policy of the plan, benefit design, and for other matters. This model is most commonly found in the construction trades.

••• Joint Governance

In joint governance, responsibility for some or all of the critical governance factors rests with a joint Board of Trustees; pension plans governed under this model are referred to as *jointly trusteed*. A jointly trusteed plan

is set up through the use of a trust document. The trust document becomes the binding contract on the parties and cannot be arbitrarily changed without agreement of the parties.

The trustees are appointed to the Board by their principals (for example, an employer and the union(s) representing the particular workers), in accordance with the relevant trust agreements. Joint boards are numerically balanced in voting power, although in some cases the actual number of trustees on each side is not the same. Generally, the Chair is rotated between the two sides or there is a provision to appoint a 'neutral' Chair.

In jointly governed plans, the joint Board is concerned with the management of the plan. In larger matters requiring the attention of the principals [the employer(s) and the union(s) representing the members], the Board acts as a vehicle for identifying issues, developing proposals and arranging or performing research and analysis.

••• Pros of Joint Trusteeship

Although there are no hard and fast rules, joint governance is the model which the National Union and its Components favour.

Under the governance model where the employer is the sole sponsor of the plan, unfunded liabilities are the responsibility of the employer. (With respect to plans covering a large portion of our members, the employer happens to be the provincial government.) In exchange for this assumption of risk, surpluses belong to the employer with no requirement to use them for improved benefits.

In a jointly trusteed plan, both the liabilities and the rewards are shared equally. If there is a surplus, there is a requirement for the parties to agree on the use of the surplus. Uses could include pension plan improvements or reduction in contributions by both the employer and the members.

Jointly sponsored DB plans in fact contribute, in an important way, to improved funding because they reduce the level of employer exposure to deficiencies.[1] In jointly trusteed plans both the employer and workers (through their union) are both responsible for funding half of any deficiencies that arise with respect to their plans.

Jointly trusteed plans make it much more difficult for employers to shed their responsibilities for liabilities in plans. In fact, joint trusteeship obligates trustees to deal with liabilities in the near future and

not decades from now. The move in several provinces to joint trusteeship over the last decade has therefore been a significant factor in reducing liabilities of public sector pension plans.

Some other advantages of a joint trusteed plan are:

• Plan members have an equal say with the employer in all the major decisions related to the governance of their pension plan including investment practices and plan allocations;

• Surpluses generated within the plan are equally shared between plan members and the employer sponsor, and can be used for plan improvements;

• In most public sector plans which our members belong to, joint trusteeship makes it more difficult for future governments to interfere with the benefit structure and the investments;

• Information on all aspects of plan operations is generally more accessible;

• Increased pension services could be provided if desired; and

• The potential to engage in socially responsible investment (see section entitled *Socially Responsible Investment*).

• • • A Cautionary Note Concerning Joint Trusteeship

Joint trusteeship of pension plans is an important progressive policy objective for unions – but the pursuit of that objective can be fraught with peril if the union does not have a clear understanding of what it is trying to achieve and the reasons as to why it is trying to achieve it.

The key disadvantage in joint trusteeship is that any liabilities accruing to the plan in the future become the shared responsibility of both the employer and plan members, rather than being restricted to the employer. Any future unfunded liabilities will most likely result in equal premium increases for the employer and for plan members.

With joint governance comes responsibility.

Worker representatives are responsible for ensuring that pension fund investments will provide promised benefits to plan members. They are also responsible for implementing policies and guidelines that reflect workers' goals and interests and for ensuring that the ongoing operations of the plan are carried out satisfactorily.

If things go wrong, it isn't possible to pass the blame onto the employer. As a joint trustee of the pension plan, the union gets to share the

rewards, and the blame.

Plans often have a guaranteed benefit. In the public sector, this guarantee may be legislated. With joint control, this guarantee may no longer exist. As well as obtaining the rewards from successful management and investment of pension monies, in this model, workers also share the many risks.

Unions may not be well equipped, at least initially, to play an effective role in the process. Pensions can be an intimidating subject. Specialized knowledge is required, with a great deal of additional information being required for union representatives to play an effective trustee's role. Additional union resources, as well as adequate education and training in pensions and related areas, will be needed.

Unions must never let a short- term bargaining goal become a long-term liability. Before putting joint trusteeship on the bargaining table, a union should know why it's a priority and whether the union has the capacity to deal with the many complexities of joint trusteeship.

••• Multi-Employer Pension Plan (MEPPs) Governance

As noted above, most workplace pension plans are sponsored either by the employer alone or jointly by the employer and the union. Each employer providing an occupational pension plan has its own pension plan and a separate pension fund.

As the name suggests, a multi-employer pension plan (MEPP) is one where unrelated employers agree to participate in a single pension plan, because their employees are engaged in similar types of employment within a specified geographic area.

Typically, there will be a large number of small employers, with employees moving frequently between them. A MEPP allows plan members to move between employers without losing all or part of their pension, because the pension benefit is determined by service at more than one employer. A MEPP may be collectively bargained or established by legislation.

Very often in private sector MEPPs, the participating employers commit to a given level of contributions with no contributions coming from the employees.

Most MEPPS will have some form of joint trusteeship. The trustees, using actuarial advice, determine the level of contributions that can be

supported by the contributions.

Pension standards legislation, both federal and provincial, usually includes special sections to deal with the various facets of MEPPs, including definition, administration, participation, eligibility, vesting and locking-in, portability, termination and other matters.

While many similarities exist across jurisdictions, the applicable statutes are by no means identical and, in fact, there are some important differences. For example, Newfoundland does not define a MEPP and provides no specific administrative requirements. As another example, while many provinces make participation in the plan optional, Manitoba makes it compulsory for full-time employees and Newfoundland's legislation is silent. Vesting and locking-in provisions can also be quite different across jurisdictions.

For specific arrangements related to a MEPP, the relevant federal or provincial supervisory authority should be contacted.

••• A Final Note

While the differences between the governance structures of pension plans can appear quite minor at first glance, their implications can dramatically affect the way that unions and plan beneficiaries can or cannot play a role in administering a pension plan and fund.

The most significant point of differentiation among pension plan governance models is the source of real policy direction for a plan. Is policy (such as benefit and contribution levels) set by the plan sponsor solely, or by the plan sponsor based upon the advice of an 'advisory' body, or jointly by trustees representing either the employer or plan members?

Wherever the pension plan lies on the continuum of a governance model, the most critical point is to develop a structure within that governance model which best facilitates and creates accountability, with at least meaningful input, if not control, from the workers whose money is being 'trusteed' for their retirement.

[1] Murray Gold, *Current Pension Issues and Trends,* Koskie Minsky LLP (Toronto: 2005) p. 7.