Pensions

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Main points

In this chapter, we report the result of our study of the adequacy of governance processes for the Government's 14 pension plans. We studied the governance processes these pension plans used for the period October 1, 2001 to September 30, 2002.

We found that the Government's pension plans need to improve their governance processes. The pension plans recognize that they need to improve their governance processes. About half of those plans have undertaken projects to do so. We make six recommendations to help the pension plans make those improvements. We recommend that the pensions plan boards develop strategic plans, define responsibilities and their operational information needs, develop communication plans, and establish policies for code of conduct and governance self assessment.

Over the next few years, we plan to assess the pension plans' progress toward improving their governance processes.

Glossary

Beneficiary – a person who receives or is entitled to receive benefits.

Defined benefit pension plan – a pension plan that specifies the pension that members of the plan receive on retirement or the method of determining the pension.

Defined contribution pension plan – a pension plan in which the members' contributions are fixed, usually as a percentage of pay (except for the Saskatchewan Pension Plan, whose members can contribute up to $600 each per year). A member's pension is based on the member's and the employer's contributions made on behalf of the member and investment earnings on those contributions.

Fiduciary responsibility – under common law, board members owe a duty of loyalty to those persons whose interests they are protecting. Board members cannot be in a conflict of interest with their board duties or profit from their board duties because of personal interests. Board members must deal fairly with the members of the plan.

Government enterprises – are government organizations that have the financial and operating authority to carry on a business. This includes contracting in their own name and selling goods and services to individuals and non-government organizations as their principle activity and source of revenue (e.g., Saskatchewan Power Corporation, SaskEnergy Incorporated).

Government service organizations – are all government organizations except government enterprises (e.g., Saskatchewan Health, Saskatchewan Learning).

Pension liability – the present value of pension benefits earned as determined by an actuary using the pension plan’s best estimates about future events and an appropriate actuarial method as recommended by The Canadian Institute of Chartered Accountants for accounting purposes.

Pension plan board – is the oversight body identified in the pension plan's act or plan document that acts as the administrator and is the body to which plan management reports. The pension plan board may be referred to as a committee, commission, or trustees in some cases.

Unfunded liability – the amount by which the pension liability exceeds the assets of the pension plan.

Purpose of chapter

The Government's pension plans are significant to the Legislative Assembly, members of the pension plans, and the public. The Government incurs significant cost to provide pension benefits. In addition, through the plans, the Government manages a significant amount of assets and pension liabilities. Note 7 to the Government's summary financial statements for the year ended March 31, 2002 shows an unfunded pension liability of $3.9 billion for government service organizations and a pension surplus of $97 million for government enterprises.

In this chapter, we report the results of our study of the governance processes of the Government’s 14 pension plans (see Exhibit on page 170) and our future work plan.

Governance processes

In our 2001 Spring Report, we said we planned to study the governance processes of the Government’s pension plans and report in a future report. We have now completed that work.

When a pension promise is made, this is the first step in the creation of a complex arrangement known as a pension plan. The appropriate management and oversight of this complex arrangement is critical to the fulfilment of the pension promise for both defined contribution and defined benefit plans. The Government’s pension plans are no exception.

Importance of governance processes

The Government must ensure that all its pension plans have good governance processes. Good governance processes help to ensure that the Government can pay the pensions promised. If pension plans do not have adequate governance processes, the Government may have difficulty paying the pensions promised for its defined benefit pension plans. For government run defined contribution pension plans, the Government and its members may find that there is not adequate money in each member’s account to provide a reasonable pension.

In Saskatchewan, most government pension plans have their own Acts. A few, under *The Pension Benefits Act, 1992*, have plan documents. The Acts and plan documents are complicated. Also, each Act or plan document is unique. These Acts or plan documents give varying powers and duties to the pension plans' oversight bodies (the pension plan boards).

These complexities and differences from plan to plan increase the risk that the plan, the board, or the Government may inadvertently make a mistake, or be perceived to have made a mistake. Pension plans can reduce this risk by ensuring their board members have appropriate knowledge and skills. If a mistake occurs, the members of the plan, collectively or individually, can hold the parties involved accountable.

The problems that can occur are not restricted to a direct violation of a specific section of a pension Act or plan document, but can involve the application of common law. In recent years, the courts have increasingly used the concept of fiduciary responsibility as a tool to remedy perceived inequities. The Supreme Court of Canada has dealt with the issue of fiduciary obligations in a number of recent cases. While the concept of fiduciary duty is subject to different interpretations, the one overriding feature of a fiduciary relationship is the dependency or vulnerability of the beneficiary.

The dependency or vulnerability of the beneficiary can range from the use of pension plan surpluses, to day-to-day decisions, and in some cases, to the right to receive a pension. In several government pension plan Acts, wording, such as, "no allowance shall be granted to the widow or child of a superannuate or employee if the widow or child is in the opinion of the board unworthy of it", still exists. Obviously, pension plan boards have the ability to exercise significant power over beneficiaries.

In the use of this power, there is risk that the board may not fulfil its fiduciary responsibility in a given case or cases and/or across a period of time. Good pension governance processes can manage and control this risk. The Government can reduce the risk of lawsuits by ensuring that boards of pension plans use sound governance processes.

Objective of our work

The objective of our work was to study the adequacy of governance processes used by the Government's pension plans.

We studied the governance processes the Government's pension plans used for the period October 1, 2001 to September 30, 2002.

Criteria

Auditors use criteria to evaluate the matters that they examine. Criteria are reasonable and attainable standards of performance and control against which auditors can assess the adequacy of systems and practices. To complete our study, we developed criteria based upon our review of relevant literature and best practices. We provided our proposed criteria to the pension plans' administrators for comments and suggestions. We received plan administrators' suggestions and made necessary changes to our criteria. We reported the proposed criteria in our 2001 Fall Report – Volume 2. The administrators supported the revised criteria.

We used the following criteria for the Government's pension plans for our study.

Pension plans should have processes to ensure that:

- Board members have adequate knowledge.
- The board approves an appropriate delegation of authority.
- Board decisions are properly documented.
- The board monitors operations on an on-going basis.
- The board has an appropriate external communication policy.

Assurance standards

We completed our work in accordance with the standards for assurance engagements established by The Canadian Institute of Chartered

Accountants and obtained a moderate level of assurance. We did the procedures we considered necessary to meet those standards. Our procedures consisted of studying relevant documents, and discussion and analysis. Our work does not constitute an audit.

Our conclusions

Based on our work, we concluded that the Government's pension plans need to improve their governance processes. The pension plans recognize that they need to improve their governance processes. About half of the Government's pension plans have projects underway to improve governance processes.

Boards and appointing bodies did not always have processes to ensure that all board members have adequate knowledge. Also, most boards did not have processes to clearly delegate authority to their management and in some cases, they did not document and approve their delegation of authority to outside professionals. While boards generally documented their decisions well, they often did not clearly set out their role and responsibilities. Nor did most of them have strategic plans including a summary of the risks the plans and their members face, the key strategies to manage those risks, and the goals and objectives of the plans.

Managers of the pension plans generally provided timely reports to the boards. However, boards did not specifically approve policies outlining all of the reports and information that they need from management and outside professionals. Most boards did not have a written code of conduct for board members and management. Nor did they have documented policies for board self-assessment. Also, most boards did not have a documented communication policy.

The following recommendations are intended to help the Government's pension plans improve their governance processes.

We recommend that the Government's pension plan boards:

1. **develop and implement strategic plans that include the goals and objectives of the plan, a summary of the risks faced by**

the plan and its members, and the key strategies to manage those risks;

2. **clearly set out the specific responsibilities of the board including clear delegation of authority, and an education plan for board members and management;**

3. **define and communicate the financial and operational information that the boards need to oversee the plans;**

4. **establish an appropriate code of conduct for board members, management and employees of the plans;**

5. **develop and implement written communication plans; and**

6. **establish policies for periodic governance self assessment.**

Our findings

We describe below our detailed findings for each criterion. For each criterion, we set out what we expected (in italics) and what we found.

Board members have adequate knowledge

We expected pension plan boards to:

- *have a clear understanding of what to do, why to do it, and to whom they are accountable;*
- *define a clear mission statement for their plans;*
- *be qualified and knowledgeable to adequately carryout their duties and responsibilities; and*
- *maintain qualified and knowledgeable board members and management and have a written succession plan that identifies the required skills and knowledge.*

We found that pension plans need to improve their understanding of what to do, why to do it, and to whom they are accountable. Pension plans do have an understanding of these issues from their legislation or plan document, but it is not always clear and complete. A number of pension plans recognize they need to make improvements in this area. These pension plans have governance projects underway. Part of the governance projects will address what the plans do, why they do it, and to whom they are accountable.

To ensure that staff can contribute fully in achieving an organization's objectives, they must understand what the organization does and why. An organization's mission statement usually defines and communicates to its staff what the organization does and why. Pension plans need to develop mission statements that clearly define what the pension plans do and why. We found that only four plans have developed mission statements. Three other plans are developing mission statements.

Pension boards generally do not have processes to ensure board members have adequate knowledge and skills to oversee the pension plans. Boards did not have documented training plans for board members. However, some boards offer ad hoc orientation sessions to new board members. Also, some pension plans set aside money each year so that board members, at their discretion, can use it for training courses and conferences.

Some plans have recognized the importance of necessary skills and knowledge for their board members. These plans have begun to develop guidelines for standard skills and knowledge for board members to oversee pension plans. We understand that these plans, on completion of these standards, intend to provide these standards to the authorities that appoint board members.

Pension plans generally have adequate processes to ensure they hire and maintain properly qualified and knowledgeable management. Pension plans do this through hiring practices that match candidates' competencies to required competencies for vacant positions. However, pension plans do not have documented training plans to ensure senior management collectively continue to maintain competencies necessary for managing pension plans.

Most pension plans did not have documented succession-planning policies for board members and senior management. Only three pension plans had documented succession plans for their senior management.

The board approves an appropriate delegation of authority

We expected the pension plans to have:

- *documented their delegations of authority in accordance with legislation and plan arrangements;*
- *documented their understandings of the roles and responsibilities with those who provide day-to-day administration for the plans; and*
- *contracts/agreements for outside professionals (e.g. actuaries, custodians, investment managers, asset consultants) setting out what those professionals can do and when.*

Management structures for the Government's pension plans vary. Some pension plans have employees while others do not. Also, some pension plans have delegated day-to-day administration to another agency of the Government. As a result, the delegation of authority for most pension plans is often not clear. When boards do not establish and clearly communicate their delegation of authority, there is a risk that some important tasks may not be done at all or done late. This could result in unsatisfied members, additional costs, and a loss of public confidence.

We found that most pension plans did not have processes to clearly document their delegations of authority. Only two pension plan boards have clearly documented and communicated the authorities and responsibilities delegated to management.

The way pension plans delegate authorities and responsibilities to outside professionals varies. Many plans delegated authorities and responsibilities to outside professionals in their statements of investment objectives. These statements describe the types of outside professionals they engaged and what the plans expected from those professionals. However, some plans did not include authorities and responsibilities for all outside professionals in their statements of objectives. Some plans did not document their delegations of authorities to the outside professionals by other means, e.g., contracts setting out what the outside professional will do and for what price.

Most pension plans did not have a documented selection process for outside professionals. For example, only one pension plan had an approved documented selection process for hiring investment managers.

Board decisions are properly documented

We expected pension plan boards to have clearly documented:

- *the boards' roles and responsibilities;*
- *decisions regarding the investment of the pension plans' money;*
- *a strategic plan including pension plans' goals and objectives; and*
- *the key risks faced by pension plans and their members and the key strategies to manage those risks.*

Most boards recognize the importance of clearly documenting their decisions. Seven of the boards have either set out their roles and responsibilities in writing or are currently doing so. Four of the boards have done this in their plan documents or trust agreements. One board set out its role and responsibilities many years ago. This board is currently reviewing its role and responsibilities to ensure they are still appropriate. Two boards have recently developed and documented their roles and responsibilities. These two boards are nearing the completion of their governance processes and expect to implement those processes soon.

We found that nearly all boards documented their decisions for investing the plans' money. All boards document minutes of board meetings and appropriately retain those minutes.

Only one board has approved a strategic plan including the key risks that the pension plan and its members face and the strategies to manage those risks. Two other boards are currently developing strategic plans.

The board monitors operations on an on-going basis

We expected the pension boards would:

- *have clearly set out their needs for regular reports from management and outside professionals;*

- *receive and review regular, accurate, and timely reports from management and outside professionals;*
- *ensure that the pension plans comply with the laws;*
- *have a written code of conduct for board members, management, and employees of the plans; and*
- *have governance self-assessments to ensure their processes continue to be effective.*

We found that the boards had not clearly documented their reporting needs for management and outside professionals. We reviewed the reports that some boards received from management and their outside professionals. We found those reports timely and had sufficient detail for the board members to understand and challenge management and/or the outside professionals. Boards have recognized the importance of defining their reporting needs to adequately oversee the plans' operations. About half of the boards we reviewed have projects underway to improve governance processes. These projects include setting out clearly the reporting needs of the boards.

Most boards did not have documented codes of conduct for board members, management, and the plans' employees. Only two boards had documented such a code of conduct.

We found five pension plans did not comply with the laws. One pension plan did not submit its 2001 financial statements to the Legislative Assembly as required by the law. This pension plan has now submitted its 2001 financial statements to the Assembly. Four other pension plans did not have processes to ensure compliance with the law when retired members receiving a pension return to work for the Government. These pension plans should establish processes to ensure all retired members receiving a pension, who have returned to work for the Government, are paid in accordance with the law or seek changes to the law.

We also reported this matter in our 2001 Spring Report – Volume 2. In November 2001, the Standing Committee on Public Accounts considered this matter and concurred with our recommendation.

We also found that most boards do not have documented processes for governance self-assessments. One board had documented its plan to formally assess its governance processes regularly. This board completed its governance self-assessment in 2001. Because of this assessment, the board has projects currently underway to improve governance. Five other boards also have governance projects underway and expect to address governance self-assessment as those projects move forward.

The board has an appropriate external communication policy

We expected the boards would have:

- *approved a written external communication policy including standards for preparing the plans' annual reports;*
- *approved how to communicate with plan members and other stakeholders; and*
- *an appropriate process to educate and fully inform plan members when they bear the investment risk.*

We found that only three of the Government's pension plans had a documented communication policy. Two of these three pension plans had specific board approved external communication policies and the remaining one had its communication policy included in its plan document. Only one of these three plans requires the distribution of the plan's annual report to its members. Another plan did not have a formal communication policy, but distributes its annual report to its members.

None of the boards approved a policy requiring disclosure of the plans' governance principles and processes in their annual reports and whether they have been followed.

In a defined contribution pension plan, the plan members bear the investment risk. Members of such plans need to have a clear understanding of the risks associated with the plan's investments because the members bear the ultimate investment risks. If such pension plans do not manage the investments well, the members may not receive the pensions they expected. Accordingly, boards of such plans should ensure that the plan members have the necessary information to understand the risks before making investment decisions. We found that the boards of the Government's defined contribution plans did not have any approved policies to help ensure the plan members have the required information and understanding to make investment decisions. Such plans did provide some information to plan members through the plans' web sites and occasional newsletters.

Our work plan for the next few years

Over the next few years, we plan to assess the pension plans' progress toward improving their governance processes. Also, we will assess the pension plans' progress to implement our past recommendations and their progress toward improving their annual reports.

As we note in this chapter, pensions are complex arrangements. The laws governing pensions are also complex. Next year, we plan to study and report best practices followed by pension plan regulators in Canada so that we can assess the adequacy of processes for regulating pension plans in Saskatchewan.

Exhibit

Government pension plans

This chapter reports on 14 of the Government's pension plans. There are nine defined benefit plans and five defined contribution plans.

On July 3, 2002, the Legislative Assembly passed *The Members of the Legislative Assembly Benefits Act* (Act) to disestablish The Members of the Legislative Assembly Superannuation Plan (Plan) effective September 1, 2002. In summary, under the Act, members of the defined contribution component will become members of the Public Employees Pension Plan. Pensions to retired members of the defined benefit component will continue to be paid by the General Revenue Fund. Therefore, the defined benefit and defined contribution components of the Plan are not included in this work.

In **defined benefit plans**, the Government promises to pay each member a pension based on the member's salary and years of service. For the Municipal Employees' Pension Plan, the municipal employers and school boards promise to pay the pensions. In 1978 (1980 for the Teachers' Superannuation Plan), the Government reduced its risk that its pension costs would be greater than expected, by closing its defined benefit pension plans to new members, except for the Judges of the Provincial Court Superannuation Plan and the Municipal Employees' Pension Plan. Since 1978 (1980 for the Teachers' Superannuation Plan), new Government employees become members of defined contribution plans.

The nine defined benefit plans included in this chapter are:

- Judges of the Provincial Court Superannuation Plan;
- Liquor Board Superannuation Plan;
- Municipal Employees' Pension Plan;
- Public Service Superannuation Plan;
- Power Corporation Superannuation Plan;
- Saskatchewan Government Insurance Superannuation Plan;
- Saskatchewan Telecommunications Pension Plan;
- Teachers' Superannuation Plan; and
- Workers' Compensation Board Superannuation Plan.

In **defined contribution plans**, the Government and the plan member each pay a fixed percentage of the member's salary into a fund (the Government no longer contributes for the Saskatchewan Pension Plan and members do not contribute for Saskatchewan Research Council Employees' Pension Plan). The member's pension is based on the accumulated contributions (i.e., total contributions made by the member and the Government over the member's career) and the investment earnings on these contributions.

The five defined contribution plans included in this chapter are:

- Capital Pension Plan Inc. (this plan includes employees of the Saskatchewan Gaming Corporation, Saskatchewan Government Insurance, Saskatchewan Transportation Company, Saskatchewan Water Corporation, and certain other agencies);
- Public Employees Pension Plan (this plan includes employees hired by the Public Service Commission, Saskatchewan Telecommunications, and Saskatchewan Power Corporation);
- Saskatchewan Pension Plan;
- Saskatchewan Research Council Employees' Pension Plan; and
- Staff Pension Plan for Employees of the Saskatchewan Legal Aid Commission.

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