KOSKIE MINSKY

JUSTICE MATTERS

Trustee Governance Roles, Responsibilities and Accountabilities

CUPE National

May 13, 2022

Murray Gold, Partner
E-mail: mgold@kmlaw.ca

Contents

1. Governance Roles and Responsibilities
2. Key Governance Documents
3. Trustee Accountability
4. Confidentiality Policies of Plan Boards
5. Fiduciary Obligations Update – ESG and the Climate Crisis

Governance Roles and Responsibilities

- Pension plans have two levels of governance
  - Sponsor
  - Plan administrator (fiduciary)
- **Sponsors** determine whether to offer a pension plan, and also determine its type and the level of benefits
- **Plan Administrator** administers the pension plan as provided by the Sponsors, subject to regulatory requirements

Governance Roles and Responsibilities

- Sponsors
  - Generally, not fiduciaries
    - Permitted to act in their self-interest, subject to pension standards legislation
  - Sometimes, legislation or plan documents create ‘Sponsor Boards’, and impose obligations
  - Trade unions may have a general duty of fair representation
  - Sponsor responsibility for oversight of appointed trustees

Governance Roles and Responsibilities

- Plan Administrator
  - In jointly sponsored plans, the Administrator is may be a Board of Trustees (50/50 composition), a Board of Directors or a pension committee
  - In multi-employer plans, it is generally a Board of Trustees (at least 50% representing members)
  - In single employer sponsored plans, it is generally the employer
  - Pension committee (composition?) also qualifies

Governance Roles and Responsibilities

- Role of the Plan Administrator
  - Administer the pension plan as it is established and amended by the Sponsors
  - Invest the assets of the Plan, i.e. the Pension Fund
- Plan Administrator is a fiduciary
  - Must act solely and exclusively in the interests of the members
  - Conflicts of Interest prohibited

Governance Roles and Responsibilities

- Plans also engage a ‘custodial trustee’
  - On the investment side, custodians implement directions of investment managers to buy or sell securities
  - On the administration side, they are typically responsible for receiving contributions and making payments to members

Governance Roles and Responsibilities

- Pension Advisory Committee
  - Ontario PBA allows members and retired members to establish an ‘Advisory Committee’
    - Majority vote to establish (union can act for its members)
    - At least one representative per class of member
    - Administrator must conduct vote to establish the PAC
    - Annual meetings with Plan Actuary and investment advisor
    - PAC expenses paid from the pension fund
    - PAC has access to plan records
    - Statutory right to PAC not available if members have representation on the plan administrator

Governance Roles and Responsibilities

- Access to Information
  - Members entitled to information when eligible to join, annually, on termination of membership/retirement
  - Members and their trade unions are entitled to inspect and copy (at plan administrator's office or at FSRA) prescribed plan documents and 5 years of correspondence between the administrator and FSRA

Governance Roles and Responsibilities

- Underlying governance challenges
  - Pension plans make pension promises (liabilities) and accumulate assets to secure those promises
  - Both a plan's assets, and its liabilities, fluctuate in value, giving rise to deficiencies and excesses
  - Managing the balance between a plan's assets and its liabilities is an exercise in risk management

Governance Roles and Responsibilities

- Underlying governance challenges
  - The riskiness of a plan's asset mix is governed by its SIPP; its funding risks are addressed in a Funding Policy
  - What are the roles of sponsors and administrators in setting these risk levels?
    - Sponsors ultimately bear the risk, through higher or lower contribution rates

Governance Roles and Responsibilities

- Underlying Governance Challenge
  - Do investment and funding decisions have to consider benefit security? If so, do they have to be made prudently, i.e. by a fiduciary?
  - Or, is the only question one of ‘risk appetite’? If so, then they may be sponsor decisions.

Key Governance Documents

- Pension Governance Documents
  - Statute and Regulations (statutory plans)
  - Sponsorship Agreement
  - Trust Agreement
  - Pension Plan Text
  - Collective Agreement
  - Board Policies
- All pension governance documents subject to pension standards legislation

Key Governance Documents

- Statutory Plans (i.e. plans established by statute)
  - Private documents (trust agreement, plan text, etc.) cannot override governing statute and regulations
    - But private documents can be legally binding to the extent that they supplement the statute/regulation
  - In a statutory plan, the statute and regulations prevail over any private documents that conflict with them

Key Governance Documents

- Sponsorship Agreement
  - Generally, the foundational document in a non-statutory JSP
  - An agreement between a Plan's sponsors defining the terms of their joint sponsorship
  - Sponsorship Agreements may anticipate other agreements, such as a trust agreement or plan text, and define their essential terms
  - Sometimes, a 'Sponsorship and Trust Agreement' defines both the Sponsor and Trustee roles

Key Governance Documents

- Trust Agreement
  - Agreement between sponsors (and trustees) establishing trust relationship between trustees and beneficiaries
    - Governs appointment of trustees
  - Typically, a trust agreement defines the powers, duties and protections (indemnity and limitation of liability) of trustees
  - If Trustees must be signatory to the Trust Agreement, or sign an ‘Acceptance of Trust’

Key Governance Documents

- Plan Text
  - Plan text document sets out the contribution requirements and benefits provided under the Plan
  - The Plan may be part of the Trust Agreement, in which case it would rank on a par with it
  - If the Plan is not part of the Trust Agreement, it would generally rank, in the event of conflict, as subordinate to the Trust Agreement in regard to the use of trust assets, surplus claims and the powers of trustees.

Key Governance Documents

- Custodial Agreement
  - Agreement between the plan administrator and a custodial trustee to hold the assets of the pension fund on behalf of the plan trustees and
    - maintain accurate records of the fund's holdings
    - safe-keep holdings and execute trades,
    - collect interest and dividend payments,
    - pay withholding or transaction taxes
    - engage in securities lending (by express agreement)
  - Custodian also pays benefits and collects contributions

Key Governance Documents

- Board Policies
  - Trustees generally have authority to determine their internal practices and procedures
  - Policies are adopted for a number of reasons,
    - To establish rigorous procedures to ensure that all relevant factors and interests are considered
    - To ensure consistency and fairness in the decision-making process
    - To create a record of the Plan Administrator's process that satisfies due diligence requirements

Key Governance Documents

- Board Policies
  - Unless they conflict with Plan documents, Board Policies are legally enforceable in accordance with their terms

Key Governance Documents

- Collective Agreement
  - Collective agreement creates obligations between the employer and the trade union
  - In a single employer sponsored plan, a collective agreement may require an employer to make changes to the pension plan, i.e. to improve a benefit
  - Where the employer does not have the authority to change the plan, a collective agreement may create employer obligations outside of the plan

Key Governance Documents

- In the event of conflict between the CA and other plan governance documents, much depends on what the CA says and whether the employer has the unilateral legal ability to reconcile the conflict through plan amendment
  - If it can change the plan, consider a grievance to compel the employer to follow through on a collective bargaining commitment
  - If it cannot change the plan, the employer may be obliged to comply with the CA outside the plan

Trustee Accountability

- Trustees are accountable to beneficiaries through the Courts
  - Members may hold Trustees accountable through legal proceedings
  - Breach of Trust – Trustees are personally liable for breach of trust (some protection through indemnities and limitation of liability provisions)
  - Trustees have a ‘duty to account’, and may be required to produce records demonstrating how the trust’s assets have been handled

Trustee Accountability

- Trustees are accountable to the Sponsors that appoint them
  - Sponsors typically have authority to appoint, and to terminate the appointment, of trustees
  - In order to discharge their appointment and oversight responsibilities, Sponsors may consider the performance of their appointees
  - Except where Plan documents create specific obligations to Settlors, Trustee obligations are to the Plan's members

Trustee Confidentiality

- Trustees may adopt Confidentiality Policies
  - Protect decision-making processes of the Trust
  - Protect confidential or commercially sensitive information
  - Protect private information of staff or members

Trustee Confidentiality

- Confidentiality Policies
  - Approaches to confidentiality include
    - Deem all information to be confidential, subject to ‘declassification’
    - Information confidential only if stamped ‘Confidential’
    - Identify categories of Confidential Information
- Supplements to Confidentiality Policies
  - Stakeholder Disclosure/Communication Policy
    - Documents prepared for disclosure
  - Stakeholder Consultation Policy

Fiduciary Duty Update

- Origins of the ‘fiduciary obligation’ in the law of trusts
- Trust law – unique among legal institutions because ownership is divided into two parts:
  - Legal ownership, and
  - Beneficial ownership

Fiduciary Duty Update

- Legal ownership
  - Ability to deal with the asset; i.e. sell, trade, collect interest, dividend, vote proxy, etc.
  - Legal ownership is in the trustees

Fiduciary Duty Update

- Beneficial Ownership
  - The benefit, or beneficial use, of the asset
  - Beneficial ownership is in the beneficiaries
- So, the legal owner (trustee) has power over the asset, but the asset is not for the legal owner, but is rather for the beneficiary

Fiduciary Duty Update

- Where the law sees power (trustee) and vulnerability (beneficiary), it imposes strict, i.e. *fiduciary* obligations from the trustee towards the beneficiaries
- Key principles:
  - Best interests of beneficiaries (duty of loyalty)
    - No Conflicts of Interest
  - Prudent Standard of Care (duty of care)

Fiduciary Duty Update

- Duty of loyalty
  - Pension funds are generally considered to be trusts that provide a financial benefit, i.e. a retirement pension
    - Socially significant financial benefit
  - Best interests of beneficiaries have therefore been considered their best financial interests
    - Explicit in British Columbia PBSA, implicit elsewhere

Fiduciary Duty Update

- Duty of loyalty
  - Duty of loyalty generally means that trustees must invest in the best financial interests of plan beneficiaries
    - No other moral, political or social objectives permissible
  - What are beneficiaries' best financial interests?
    - Best returns, for an acceptable level of risk
    - Both risk and return are integral to trustee duties in regard to pension investing

Fiduciary Duty Update

- Duty of Care
  - Often referred to as ‘due diligence’
  - Challenge: understand key elements of investment decision
    - Rely on staff, third parties with appropriate expertise to help analyze, distill, evaluate risks and returns
  - Challenge: mitigate/evaluate risk, evaluate return
  - Decision made on the basis of due diligence, risk identification, risk mitigation, expectation of return

Fiduciary Duty Update – ESG & Climate

- ESG and Climate
  - ESG, in general, is relevant if and to the extent that they relate to either risk or return
  - Pension investments cannot be for the purpose of achieving ESG objectives, but must be made within a risk/return framework
  - So,
    - ESG – relevant if they have an expected impact on risk or return
    - ESG – cannot be considered as dominant factors

Fiduciary Duty Update – ESG & Climate

- ESG and Climate - Climate crisis
  - International Panel on Climate Change (IPCC) says ‘safe’ level of average global warming is 1.5°
  - IPCC says to reduce GHG emissions by 45% by 2030
  - International Energy Agency (IEA) says no fossil fuel developments beyond those already committed
  - Collectively, we are not on a path to 1.5° or 2°
  - Significant global crisis, becoming more severe

Fiduciary Duty Update – ESG & Climate

- ESG and Climate - Climate crisis
  - IPCC "Mitigation of Climate Change" (April 2022)
    - Global GHG emissions in 2019 were 12% higher than in 2010, 54% more than in 1990
    - 42% of all GHG emissions since 1850 occurred between 1990 and 2019
    - Remaining carbon budget to keep within 1.5 degrees is 500 GT CO_2 vs 410 GT between 2010-2019
    - Crisis is immediate and urgent

Fiduciary Duty Update – ESG & Climate

- ESG and Climate
  - Climate change presents significant risks and opportunities
    - Risks include physical damage, supply chain disruptions, coastal and waterway flooding, drought, changing incidence and distribution of disease, severe storm damage, increased carbon taxes and regulatory limits on carbon emissions
    - Opportunities include renewable power generation, firms with relatively low carbon emissions, green technologies

Fiduciary Duty Update – ESG & Climate

- ESG and Climate
  - Greenwashing risk b/c ESG has become a marketing tool
  - Investment managers may promote ESG funds (with higher fee structures) with a promise of achieving ESG objectives
    - However, ESG funds are not generally very different from non-ESG funds, as ESG factors are typically given a small weight in asset allocation
    - Funds and members may be misled by ESG claims

Fiduciary Duty Update – ESG & Climate

- In general, academic research suggests that ESG Funds don’t have a significant impact on ESG issues and don’t invest very differently than non-ESG Funds

Fiduciary Duty Update – ESG & Climate

- "Doing Good or Feeling Good", EDHEC Business School, August 2021 evaluated a number of ESG Funds on the basis of their emissions-related green scores, and concluded
  - Green emissions scores are not a major factor (12% weight) in portfolio construction
  - Higher green scores may be achieved by underweighting energy companies
  - Use of green scores does not promote change

Fiduciary Duty Update – ESG & Climate

- ESG and Climate
  - Long-term view of commitments and investments
  - Engage expert advice so trustees appreciate nature of climate risks and can evaluate their weight
  - Trustees can rely on expert analysis but should ensure the work was based on appropriate assumptions
  - Trustees, not experts, make final decision

Fiduciary Duty Update – ESG & Climate

- Fiduciary interaction with government
  - Carbon taxes – indirect measures
    - $50/ton in 2022, rising by $15/year to $170/ton in 2030)
  - ‘Emissions Reductions Plans’ - direct measures
    - 2030 ERP ($9.1 billion) released March 29, 2022
      - 40% GHG reduction target by 2030 relative to 2005
      - Net zero target by 2050
      - Sector strategies: oil and gas production, building stock, electric vehicle subsidies and charging stations, lever provincial, municipal and other funding (Low Carbon Fund), green electricity generation, agriculture, new tech
      - Methane emission reductions, fuel efficiency standards

Fiduciary Duty Update – ESG & Climate

- Pension funds and climate change #1
  - Are these measures sufficient?
  - What is the position of pension funds vis-à-vis government policy?
    - Mandatory vs. voluntary GHG limits

Fiduciary Duty Update – ESG & Climate

- Pension funds and climate change #2
- Shareholder resolutions
  - GHG emission disclosure
  - Business plans for 1.5 degrees
  - Cease investments in new fossil fuel development
  - Recycle fossil fuel profits in renewables
  - Consider low emission production technologies, low emission products
  - Executive compensation and GHG reduction

Fiduciary Duty Update – ESG & Climate

- Pension funds and climate change #3
- Other regulatory issues with fiduciary interface
  - GHG emission disclosure
    - Voluntary based on task Force of Climate Related Financial Disclosures
    - Securities laws – generally mandate disclosure of **material** risks
    - Securities and Exchange Commission (US) proposes mandatory scope 1 and scope 2 GHG emissions disclosures, scope 3 disclosures where ‘material’ to the business
    - Disclosure is basic –I f we don’t know current emissions, we don’t know risks, and don’t know if GHG emissions are declining, or rising
  - Greenwashing regulation
    - Mandatory corporate disclosure of climate plans (i.e. net zero), with enforcement

Fiduciary Duty Update – ESG & Climate

- Pension funds and climate change #4
- Decarbonization vs divestment
  - Decarbonization - engage with investee companies to meet reduced emissions targets
  - Divestment - divest from companies that present unacceptable investment risks, or if a portfolio without them presents similar overall risk/return profile

Fiduciary Duty Update – ESG & Climate

- Pension funds and climate change #5
- Offsets
- Note that a ‘net zero’ target is a **net** target
  - One mechanism for netting is the purchase and trading of ‘offsets’
  - Offsets are governed by Article 6 of Paris Agreement
  - Not surprisingly, ‘offsets’ are becoming big business

Fiduciary Duty Update – ESG & Climate

- Offsets are not yet regulated
- What qualifies for offset
  - Reduction in atmospheric GHG through removal, i.e. incremental forest cover
  - Avoided emissions – i.e. emissions that would have occurred in the absence of an offset
    - How to evaluate whether the emission would have occurred?
    - ‘Additionality’
  - Preservation of natural areas that would otherwise be destroyed

Fiduciary Duty Update – ESG & Climate

- Offset issues
  - ‘Additionality’ –removal, reduction, ‘co-benefits’
  - Measurement – how much removal/avoidance
  - Permanence of offset, i.e. if offset is carbon capture, utilization and storage (CCUS), what happens if there is a leak of CO_2
    - Does the possibility of a leak reduce the value of the offset, or is the value of the offset reversed in the event of a leak
  - Timing of credit vs. timing of reduced emission, i.e. credit today for future removal/avoidance