# Chapter 4
# Department of Finance
# Pension Plan Governance

## Contents

# Department of Finance Pension Plan Governance

## Background

**4.1** There are eleven provincially sponsored pension plans with approximately 40,600 employees contributing to the plans and approximately 18,100 pensioners receiving benefits. Total pension benefits paid in the plans' 2000-2001 year totalled $286.5 million. During that year employees contributed $86.3 million to the plans while government paid $93.3 million. At year end the government's plans had investments in excess of $6 billion.

**4.2** Our 2000 Report devoted a chapter to the governance and accountability structures in place for four of the pension plans. The chapter identified five key areas of responsibility in a pension plan: compliance, plan funding, asset management, benefit administration and communication.

**4.3** We recognize that our work in the area of pension governance and accountability is being done at a time when the pension industry itself is evolving and maturing. It was only four years ago in 1998 that the Senate Standing Committee on Banking, Trade and Commerce issued a report that made significant recommendations concerning the governance of pension plans in Canada. We hope, as a result of our work, that we will increase the awareness among public sector trustees and governors of the importance and value of good governance practices.

## Scope

**4.4** From the five key areas of responsibility in a pension plan we chose to conduct an audit of asset management. The importance of asset management to the long-term survival of a pension plan led us to this decision.

**4.5** There are some commonly used industry rules of thumb available that emphasize the importance of asset management to the financial health of a pension plan. The following are examples:

- eighty percent of every pension dollar comes from investment earnings;
- a one percent increase in pension plan earnings lowers required contributions by fifteen percent; and

- asset mix decisions account for 80-90% of the variance in investment returns.

**4.6** This audit examined asset management from the perspective of the Public Service Superannuation (Public Service) Plan and the Pension Plan for General Labour, Trades and Services Employees of New Brunswick School Districts (GLT&S). We selected these plans as examples of a plan established by legislation (the Public Service Plan) and a plan established through a collective bargaining process (GLT&S). We also wanted to examine a plan that used the New Brunswick Investment Management Corporation (NBIMC) as its investment manager (the Public Service Plan) and one that used other outside investment managers (GLT&S).

**4.7** Our objective for this project was as follows:

*To determine whether the governors of the pension plans have established satisfactory procedures to measure and report on the effectiveness of the asset management activities.*

**4.8** The term "asset management activities" involves a number of areas. We developed five criteria to be used as benchmarks in each of these areas to help us determine whether the audit objective was met. To ensure there was agreement on the focus of the audit, the criteria were discussed with auditee staff.

**4.9** Our comments are organized by the five criteria. We have also devoted a section to pension plan governance structure because of its fundamental importance in relation to asset management.

## Results in brief

**4.10 The identity of the plan governor of the Public Service Superannuation Plan (the Minister of Finance) and of the Pension Plan for General Labour, Trades and Services Employees of New Brunswick School Districts (the Board of Management) should be formally recognized. The duties and responsibilities of the governor should be clearly set out in pension plan documentation.**

### *Public Service Superannuation Plan*

**4.11 The governor's role in the preparation and approval of the investment policy is informal and this increases the risk that the governor's role may not be fulfilled.**

**4.12 There is no formal process in place to monitor the performance of the trustee, NBIMC. However, NBIMC is adequately monitoring its investment management staff and the contracted investment managers to ensure compliance with the applicable investment policies.**

**4.13 A number of reports are currently issued for the public service plan on an annual basis. However there is no annual report**

**that gives readers information to understand the plan and assess its performance.**

***General Labour, Trades and Services Plan***

**4.14 The Treasury Division does not have procedures in place to ensure an effective review of investment policies is conducted on an annual basis.**

**4.15 Although we have seen evidence of some good practices in use for the selection of investment managers, we see the need for clarifying roles, formalizing practices and, in some cases, improving practices.**

**4.16 There are a number of policies and practices in existence which help to ensure there is a reliable process in place to monitor and evaluate the managers and to ensure compliance with the investment policy. There is a need, however, for documented policies and in some cases improvements to processes.**

**4.17 There is no annual report that gives readers information to understand and assess the performance of the pension plan.**

## Governance structure

**4.18** Governance, as it relates to a pension plan, has been defined as "the process and structure used to direct and manage the pension operation with the objective of achieving the stated mission or objective". The person or body with the highest level of plan governance authority, according to the terms of the plan or applicable legislation, is considered to be the pension plan governor.

**4.19** One of the first challenges when we started our work on pension plan governance (see chapter 5 of our 2000 Report) was identifying the governor of the Public Service and GLT&S pension plans.

**4.20** It is very important that the governor be clearly identified, because this is where responsibility for pension plan performance ultimately rests. Asset management is a critical component of the plan governor's responsibility but it is not the only component. It is the governor who is expected to take the lead and be proactive:

- to ensure the plan has a stated mission or objective that is communicated to all plan members;
- to ensure the plan has articulated roles and responsibilities for the governor and plan administrator;
- to ensure parties responsible for each of the key pension plan components (including asset management) are clearly defined with terms of reference;
- to ensure there are clear and objective measures of performance for each of the key pension plan components;

- to ensure there is a process to evaluate the attainment of performance for all pension plan components;
- to ensure individuals responsible for the governance of the plan are provided with training and orientation to fulfil their responsibilities; and
- to ensure there are processes and criteria in place to assess the effectiveness of the plan's governance on a regular basis.

**4.21** In relation to asset management, the governor should approve the more critical strategic objectives and performance targets. We would expect the following of the governor:

- to approve the investment policy decisions, for example benchmark setting in such areas as rates of return objectives, risk tolerance and asset mix;
- to provide the final approval of the investment policies;
- to ensure investment policies and goals are kept current;
- to ensure selection criteria for investment managers are clearly established and complied with;
- to monitor and evaluate the performance of the investment manager(s) and take action when targets have not been met; and
- to assess the performance of the pension plan and report results to the plan members and the sponsor.

**4.22** To promote good governance practices, it is important that the identity of the governor and the duties and responsibilities of the governor of the pension plan be clearly disclosed. This would ensure that all parties are fully aware of the role of the plan governor. It would also ensure that the governor is aware of expectations and that the performance of the governor can be assessed.

***Governor for the Public Service Superannuation Plan***

**4.23** The *Public Service Superannuation Act* does not explicitly identify either the governor or the duties and responsibilities of the governor. We reviewed documentation made available to us and concluded, in our 2000 Report, that the governor of the Public Service Superannuation Plan is the Minister of Finance, as Chair of the Board of Management. At that time, we met with the Deputy Minister of Finance and his officials and they agreed with our conclusion.

**4.24** It is necessary to make the distinction between New Brunswick Investment Management Corporation's (NBIMC) responsibilities for asset management of the trust fund and the governor's overall responsibility for the pension plan. NBIMC clearly has the responsibility for managing the assets of the pension trust fund as evidenced by the *New Brunswick Investment Management Corporation Act* which states that the Corporation shall act as trustee for the pension trust fund. However the plan governor's role is broader. It includes the ultimate responsibility for asset management as well as the numerous other responsibilities outlined earlier.

*Recommendation*

**4.25 The identity of the plan governor of the Public Service Superannuation Plan should be formally recognized. The duties and responsibilities should be clearly set out in pension plan documentation.**

*Governor for the General Labour, Trades and Services Pension Plan*

**4.26** After reviewing various documents and holding discussions with Department of Finance officials, we came to the conclusion that the governor for the Pension Plan for General Labour, Trades and Services Employees of New Brunswick School Districts was the Board of Management.

**4.27** Documents reviewed also indicate that the Board is the trustee of the pension plan's assets. The letters of agreement with the investment counsellors include wording in support of this conclusion.

**4.28** After having established that the Board is the governor and the trustee, there was still a lack of clarity to the issue. For example, a legal opinion dated 5 November 1998 states: "…it is not expressly stated that the Province of New Brunswick Board of Management is the trustee of the Pension Plan Fund. This raises liability issues for the Pension Plan sponsors, the Province of New Brunswick Board of Management… . Further, the relationship between the Pension Committee, the Union and the Board of Management in all its capacities is not clear." The plan document does not identify the Board of Management as either the pension plan governor or the trustee of the pension plan assets.

*Recommendation*

**4.29 The identity of the plan governor of the General Labour, Trades and Services Pension Plan should be formally recognized. The duties and responsibilities should be clearly set out in pension plan documentation.**

## Public Service Superannuation Plan

### Introduction

**4.30** *The Public Service Superannuation Act* (PSSA) establishes a Province of New Brunswick sponsored, defined benefit pension plan. As at 31 March 2001 there were in excess of 18,200 active members, 8,600 pensioners and assets with a market value of approximately $2.96 billion. The Public Service Superannuation Plan is the largest of the eleven provincially sponsored pension plans.

**4.31** The New Brunswick Investment Management Corporation is the trustee and investment manager for the Public Service Superannuation Fund, as well as the Teachers' Pension Fund and Judges' Superannuation Fund. NBIMC was appointed trustee on 11 March 1996, by an Act of the New Brunswick Legislature and assumed responsibility for the management of the Funds' assets effective 1 April 1996.

**4.32** On 1 April 1998 the assets of the Funds were transferred to unit trust funds established by NBIMC. As at 31 March 2001 there were twelve unit trust funds, each one with a specific investment mandate. The Public Service Superannuation Fund holds units of each of the twelve unit trust funds in accordance with the investment policy established by NBIMC for the Public Service Superannuation Fund. Four of the unit funds have external investment managers while the remaining eight funds are managed by NBIMC's staff.

## Investment policies should exist

**4.33** Our first criterion was:

*Appropriate investment policies and goals should be prepared and approved.*

**4.34** A pension fund has only two sources of revenue, investment earnings and contributions from the plan members and the sponsor. As stated earlier, a widely used rule of thumb is that a one-percent increase in pension plan earnings lowers required contributions by fifteen percent. This underscores the importance of sound investment policies to the plan governor, to the plan sponsor, to the employees who contribute to the plan and to those receiving retirement pensions.

**4.35** We reviewed industry best practices and the provincial *Pension Benefits Act* (PBA) to help establish a basis for defining appropriate investment policies. The PBA applies to persons employed in the Province of New Brunswick but does not bind the Crown. As such the Public Service Superannuation Plan is not bound by this legislation. In spite of this, the PBA is seen as a useful benchmark. The results of our review are as follows.

**4.36** Investment policies should:

- have written procedures identifying responsibilities and accountabilities of the investment manager;
- clearly set out the reporting and review processes that the plan will use including how performance will be measured and reported;
- document the return expectation and risk tolerance of the plan;
- be approved by the governor of the plan;
- be consistent with the objectives of the pension fund and the nature of the plan's financial obligations; and
- ensure plan amendments and unexpected developments, such as dramatic changes in the economic markets, are allowed for in the policy.

### *The governor's role in investment policy approval*

**4.37** The governor's role in a pension plan is critical, as explained earlier. The governor has ultimate responsibility for all aspects of the operations of the pension plan.

**4.38** During the course of setting the long-term real rate of return for the investment policy, NBIMC officials met with the governor and other Department of Finance officials to obtain views on issues which helped determine an appropriate asset allocation strategy and the sponsor's risk tolerance.

**4.39** In addition, the governor has met informally with the Corporation on an annual basis to discuss issues relating to asset management. The Deputy Minister of Finance is a member of the Board of Directors and is exposed to board business on a regular basis.

**4.40** However, there has been no formal approval of investment policy by the plan governor.

***Review of the investment policy for the Public Service Superannuation Fund***

**4.41** We reviewed the investment policy in place for the New Brunswick Public Service Superannuation Fund, dated 1 April 2001, and examined it from the perspective of compliance with the *NBIMC Act* and with industry best practices.

Compliance with the *NBIMC Act*

**4.42** NBIMC's responsibilities for the administration of the investment policies are established by legislation. The *NBIMC Act* establishes the requirements of the policies and states: "The statement of investment policies and guidelines shall...describe the purpose and objectives of the fund or pooled investment fund, the duties of the persons responsible for the management and administration of the fund or pooled investment fund and the manner in which investments are to be considered and made."

**4.43** Based on our review we found that the Corporation was in compliance with the *NBIMC Act* with respect to the required content of its investment policies.

Industry best practices

**4.44** We concluded the policies are appropriate when compared to industry best practices with one exception. The issue is the linkage of the purpose of the plan with the objective of the investment policy.

**4.45** The investment policy of the plan, as documented by the trustee (NBIMC) states:

> *... the following objectives should form the basis of the PSSF investment policy;*
>
> *maximize investment returns; and*
>
> *protect accumulated assets.*

**4.46** The investment policy also states that "one of the corporation's objectives is to provide a long-term real rate of return on investment superior to the assumption used in the most recent actuarial valuation, which is 4.0 percent."

**4.47** The *Public Service Superannuation Act* does not document a purpose or mission for the pension plan. A statement of purpose is included in the employee booklets and brochures and it reads "to provide financial security to plan members". However, the Department of Finance indicated that this wording does not properly reflect the purpose of the plan. As a result of there not being a suitable purpose for the plan, it is not possible to establish a link with the objective of the investment policy.

***Recommendations***

**4.48 The governor has never formally approved the investment policy and we recommended the appropriate approval be sought.**

**4.49 We recommended there be a documented purpose or mission for the pension plan. We also recommended there be a clear link between the purpose of the pension plan and the long-term real rate of return objective as set by NBIMC in the investment policy for the fund.**

***Conclusion***

**4.50** Overall this criterion is partially met. The governor's role in the preparation and approval of the investment policy is informal and this increases the risk that the governor's role may not be fulfilled. From the perspective of NBIMC's responsibilities, the criterion has been met.

## Investment policies should be regularly reviewed

**4.51** Our second criterion was:

*Investment policies and goals should be reviewed on a regular basis and updated as required.*

**4.52** Once an appropriate investment policy has been prepared and approved, it is important to update the policy from time to time to ensure it continues to be appropriate in light of changing conditions. NBIMC has the responsibility to develop the policy and to keep it current.

**4.53** Our audit disclosed that NBIMC last reviewed the investment policy, as required, within one year of a funding valuation. The latest investment policy is dated 1 April 2001, while the last actuarial funding valuation is dated 1 April 2000. As well, we were informed that as a matter of practice NBIMC also examines the need for an investment policy review on a yearly basis and updates it if necessary.

**4.54** There are no legislative requirements that necessitate the involvement of the plan governor in the periodic review and update of the investment policy. As well, no formal practices have been followed by the governor in this regard.

**4.55** For some time the Department of Finance has been using the "actuarial valuation committee" to develop recommendations related to the actuarial valuations of pension plans. This committee consists of seven senior employees and reports to the Minister of Finance.

**4.56** The terms of reference for the committee have been in existence since October 1996. Some key aspects of the terms of reference include:

- to recommend appropriate terms of reference for the actuarial valuations, based on the objectives of the actuarial valuation;
- to recommend the valuation method(s) and actuarial assumptions on which the valuation is to be based; and
- to receive the actuary's valuation report and to make recommendations based on the report.

**4.57** We examined the minutes of the committee meetings back to October 1996. We noted that on one occasion the committee devoted time to examining the impact that varying rates of return assumptions would have on the pension plan. Such information provides the opportunity to equate investment risk with rates of return and to examine the impact of these risks on the expected returns.

**4.58** If such an analysis were conducted on a more frequent basis, and the results were made available to the plan governor, the governor would be in a much better position to discuss and approve investment policy changes when called upon to do so.

**4.59** NBIMC has advised us that, as part of the normal procedure to update the investment policy, they solicit input from the Minister of Finance regarding "the sponsor's risk tolerance". This communication with the plan governor is an important part of the process when considering changes to the investment policy.

**4.60** It is also important that there be communication between NBIMC and the plan governor on the governor's position on matters related to funding the plan. For instance, it would be helpful for the governor to explain planned changes to the amount or timing of contributions, planned changes to benefits and how plan surpluses or deficits are to be handled. These are all factors that should be addressed in determining the overall investment strategy.

**4.61** It is our belief that there should be a formal process established and documented within the investment policy whereby the governor of the plan participates in a productive discussion with NBIMC representatives on matters such as the governor's view on plan funding and risk tolerance. Following the appropriate communication between the parties, there should be a process to ensure the plan governor's approval is in place. While the governor and NBIMC should consider which policy changes should be approved by the governor, we suggest that as a minimum, approval be given to those policies (i.e. asset classes and allocation percentages) that are critical to the performance of the fund.

***Recommendation***

**4.62 We recommended the investment policy include the requirement for appropriate communication with the plan governor when changes to investment policy are prepared.**

***Response from NBIMC***

**4.63** *NBIMC undertakes periodic communication with the plan sponsor in regards to plan asset mix reviews. The NBIMC Board considers it important to incorporate the sponsor's views in making these decisions. The Board would also consider plan Funding Policies developed by the Sponsor to be valuable information to be considered in making its decisions.*

**4.64** *Although we do not consider communication with the plan sponsor an appropriate subject of the Investment Policy such communication is normal practice as evidenced by the Business Plan of the Corporation.*

**4.65** *We would point out as well that one of the reasons the Deputy Minister of Finance is a member of the Board is to ensure the Plan Sponsor is aware of Investment Policy matters and investment results as well as other important information. We provide the members of the Board with documentation in advance of meetings and minutes of all decisions. In our view this meets the requirement of this recommendation.*

***Recommendations***

**4.66 We recommended the role of the plan governor be formalized to ensure that the governor's approval is required for certain changes to the investment policy (i.e. asset classes and allocation percentages).**

**4.67 We recommended the actuarial review committee be used by the governor to provide information that can be used to assist in making well-informed decisions on the investment policy of the plan.**

***Departmental response***

**4.68** *The concept of a plan governor was not well established at the time the NBIMC legislation was drafted in 1994.*

**4.69** *Given that the Minister is responsible for ensuring that all benefits are paid, the Department agrees that there is a need to establish mechanisms to ensure that the NBIMC develops an appropriate investment policy that takes into account the risk tolerances of the Province, including funding and accounting considerations. The Department will look at how these steps can be undertaken in cooperation with NBIMC. There may be certain policy and implementation issues that will take some time to resolve.*

***Conclusion***

**4.70** There are informal procedures in place to involve the plan governor in the review and update of the investment policy. NBIMC has procedures in place to ensure the investment policies are kept current. However, since the plan governor's role has not been set out in a formal way, that would ensure a consistent involvement in the review and update of the investment policy, we conclude that this criterion has been only partially met.

## Selection of investment managers

**4.71** Our third criterion was:

*Selection criteria for investment managers should be clearly established and complied with.*

**4.72** Selecting the most appropriate investment manager to make investment decisions is an important aspect of the asset management process. The selection process requires a sound methodology to be in place to guide the decision to utilize external managers as well as to make the choice between the managers.

**4.73** The *Public Service Superannuation Act* names NBIMC as the trustee for the pension funds and it directs that the funds be invested in accordance with the *Trustees Act.* Legislation requires the Corporation to develop and adhere to a statement of investment policies and guidelines. It also allows NBIMC to enter into agreements with others to act as trustee or to provide investment counselling services or other services.

**4.74** As a result of the responsibilities assigned to NBIMC by legislation, there is no role for the plan governor to play in the selection of the fund's investment manager. Since the Corporation has also been granted the authority to hire external investment managers, there is no direct responsibility for the plan governor in this process.

**4.75** At 31 March 2001 less than 5% of the fund investments were with external investment managers. The remainder was managed directly by NBIMC.

**4.76** To date, NBIMC has conducted three searches to hire external managers. Following the experience in the first search, NBIMC developed a process for selection of external investment managers. This process was subsequently approved by the NBIMC Board of Directors as the Key Vendor Selection Policy.

**4.77** We reviewed the documentation on file to establish if there was compliance with the process approved by the Board of Directors. We conclude that NBIMC has complied with the approved process for selecting external investment managers.

***Conclusion***

**4.78** This criterion has been met. NBIMC follows clearly established practices in their hiring of external managers. The governor has no control in the selection of the investment manager since NBIMC is appointed by legislation.

## Monitoring performance of investment managers

**4.79** Our fourth criterion was:

*The investment manager's performance should be routinely monitored and evaluated with corrective action taken as required. Compliance with the plan's investment policies and goals should be monitored.*

**4.80** It is reassuring to know that investment managers have been carefully selected, using a pre-approved process. However, choosing the right investment managers is not the end of the process. There must be a means of ensuring that managers continue to perform at an acceptable level.

**4.81** Receiving information on manager performance on a regular basis gives the opportunity to take action where performance has not met expectations. It also allows the opportunity to ensure that managers are complying with investment policies and other agreed upon terms.

**4.82** The need for the performance information is seen at two levels; between the plan governor and NBIMC and between NBIMC and its external and employee managers.

### *Monitoring and evaluating NBIMC*

**4.83** Legislation does not establish procedures for the plan governor to follow in monitoring and evaluating the performance of NBIMC. As well, based on our review, we have been unable to identify Board of Management or departmental policies covering the plan governor's role in this regard.

**4.84** We held discussions with the Department of Finance to identify the procedures they follow to monitor the investment results. They indicated that they compare actual results against benchmarks set by NBIMC and also against industry benchmarks. Results are reported to the Deputy Minister and, if significant, to the Minister. If action is required, it would be initiated at the Deputy Minister level.

**4.85** Officials at NBIMC confirmed that although there is no formal monitoring and evaluation of their role, as trustee or investment manager, there are a number of checkpoints:

- the Deputy Minister of Finance is a member of the Board of Directors;
- NBIMC officials meet with the Minister of Finance at least once during the year;
- NBIMC produces an annual report that is tabled in the Legislature; and
- the Corporation appears annually before the Standing Committee on Crown Corporations.

***Monitoring and evaluating NBIMC's investment management staff***

**4.86** NBIMC has a system in place to monitor and evaluate the performance of its investment management staff. This system is also designed to ensure there is compliance with the investment policies.

**4.87** In our opinion the reports prepared are providing sufficient detail to enable the Chief Investment Officer to monitor investment strategies and to enable the President to monitor the investment policy and investment results against goals and relevant benchmarks, specified within the investment policy.

**4.88** It is also our opinion that the President's quarterly report to the Board of Directors provides sufficient information to the Board to enable it to monitor and evaluate the performance of NBIMC's internal investment managers.

***Monitoring and evaluating NBIMC's external investment managers***

**4.89** The decision by NBIMC to hire external managers was prompted by a change in investment policy. A decision was made to increase the amount of international assets and NBIMC decided this required specialized investment expertise that was not available internally. NBIMC has since increased the number of specialized investment mandates managed externally.

**4.90** We reviewed the monitoring and evaluation processes carried out by NBIMC for the two investment managers with which it had dealings for a period of one year or more. One manager had been on contract with NBIMC since the Corporation's inception, although its mandate was revised in December 1999. The other manager has been under contract since April 2000.

**4.91** The contracts set the investment policies for the managers as well as the reporting requirements to NBIMC. To monitor the external managers, staff of NBIMC maintain records of all investment transactions carried out by the managers and reconcile these records to the custodian reports and the quarterly reports received from the manager. As such they are able to assess compliance with the investment policies of each of the managers and monitor and assess manager performance. At least once per year management of NBIMC meet with each investment manager to discuss investment results and investment strategy.

**4.92** We reviewed the external manager reporting requirements document and we have identified four areas not addressed by the document which we feel would assist NBIMC in the monitoring and evaluation of the external investment managers.

- **Non-compliance with investment policies** - NBIMC should consider having the policy require all external managers advise NBIMC immediately when investments do not comply with the policies.

- **Disclosure of legal suits and possible pending suits** - NBIMC should consider requiring all external managers to notify NBIMC of all legal suits and pending legal suits against them.

- **Fee structure** - Regardless of the fee structure it is important that the fees continue to be competitive, after taking into consideration the investment manager's mandate. We encourage NBIMC to re-evaluate the fee with the managers at the time of the annual meetings to ensure it is still reasonable and appropriate.

- **Monitoring of Managers -** In our opinion NBIMC should develop a means of deciding when manager performance requires intervention by the Corporation. We recommend the use of a checklist to capture the status of the situation and outline the circumstances in which NBIMC should start to monitor the activities more closely. It could also set out situations where NBIMC would put the manager on a watch-list and when it would remove the manager from the watch-list. It would be appropriate to communicate this checklist to the external managers.

***Recommendation***

**4.93 There should be a requirement in place for the plan governor to formally monitor and evaluate NBIMC, as an investment manager, on at least an annual basis.**

***Departmental response***

**4.94** *The Department agrees with this recommendation and will be taking steps to adopt it.*

***Recommendation***

**4.95 The process for monitoring and evaluating the investment managers hired by NBIMC should be further improved by introducing the following enhancements:**

- **the immediate identification of non-compliance with investment policy;**
- **the disclosure of law suits and pending law suits;**
- **ensuring fees paid are competitive; and**
- **establishing guidance on how to deal with poor performance by external investment managers.**

***Response from NBIMC***

**4.96** *Managers are currently required to confirm compliance as part of their quarterly reporting requirements. In addition, NBIMC staff monitor manager portfolios on a weekly basis to ensure compliance. Nonetheless, your recommendation on this matter will be incorporated into our procedures.*

**4.97** *We will require managers to confirm legal suits and pending legal suits in their quarterly reports.*

**4.98** *Manager fees are considered when we make the initial hiring decision. However, once the manager is in place, it becomes more difficult to assess the competitiveness of the fees as market information is* *not always readily available or reliable. Moreover, our sense is that fees do not tend to fluctuate in any great fashion on a year-by-year basis within the industry. Nonetheless, we will begin the practice of discussing fee arrangements with the external managers on an annual basis.*

**4.99** *NBIMC takes its monitoring of external manager responsibilities very seriously and has put a great deal of effort into the process. Whether to place a manager on a watch list or not is somewhat subjective as not all cases can be treated similarly. While a checklist can be developed, it is ultimately professional judgment which is needed to decide which course of action is best.*

***Conclusion***

**4.100** This criterion has been partially met. There is no formal process in place to monitor the performance of the trustee, NBIMC. However, NBIMC is adequately monitoring its investment management staff and the contracted investment managers to ensure compliance with the applicable investment policies.

## Performance reporting

**4.101** Our fifth criterion was:

> *There should be an annual report produced that gives readers information to understand the plan and assess the performance of the pension plan.*

**4.102** Our Office audits the annual financial statements issued for the Public Service Superannuation Plan. These statements are reported publicly. NBIMC produces an annual report that contains investment performance information for the fund. NBIMC's 2000-2001 annual report showed the asset mix of the fund, the fund's actual return as well as the real rate of return compared against the benchmark return for the current year. Within the annual report there is an accountability report which compares actual results against the objectives of NBIMC.

**4.103** Another means of reporting, currently in use, is an annual bulletin issued by NBIMC to the members of the plan. This bulletin contains information published in NBIMC's annual report.

**4.104** However, the Public Service Superannuation Plan itself has no annual report and as a result there is information that is not presented to members. A number of areas could be developed using the government's annual report policy as a guideline. The following are examples of areas that could be covered in a pension plan's annual report:

- the purpose of the plan;
- the plan's goals, both long and short-term;
- the plan's major activities or highlights for the year;
- actual results as compared to planned performance;
- disclosure of the total costs of administering the pension plan;
- information on the performance of the asset managers; and
- planned changes affecting plan assets and liabilities.

**4.105** The plan governor should have the responsibility to prepare and publish an annual report for the plan. Such an annual report would be made available to all contributors and pensioners.

***Recommendation***

**4.106 The plan governor should publish an annual report for this pension plan. The Province's annual report policy should be used as a guideline for the preparation of the report.**

***Departmental response***

**4.107** *The Department agrees with this recommendation and will be working with NBIMC and Office of Human Resources to develop a useful annual report.*

***Conclusion***

**4.108** A number of reports are currently issued for the public service plan on an annual basis. However there is no annual report that gives readers information to understand the plan and assess its performance. As a result this criterion has not been met.

## General Labour, Trades and Services Plan

### Introduction

**4.109** The GLT&S plan is a defined benefit pension plan sponsored by the Province of New Brunswick. As at 31 December 2001 there were in excess of 1,900 active members, 900 pensioners and assets with a market value of approximately $179.5 million.

**4.110** The terms of this pension plan are negotiated between the Board of Management and the GLT&S bargaining group. The pension plan can be revised through the collective bargaining process or, in some cases, through a pension committee. The plan document is a formal consolidation of all negotiated terms of the pension plan.

**4.111** The role of the Pension Committee is outlined in the plan document. The Pension Committee consists of ten plan members and has the power to determine changes in plan provisions within certain boundaries and to provide input to the selection of investment managers.

**4.112** Investment managers are responsible for the investment of assets of the pension plan in accordance with the policies approved by the Board of Management. There are currently three investment managers. There is a letter of agreement signed with each manager. It sets out the statement of investment policy and goals (the investment policies) and establishes the details of the arrangement between the managers and the plan.

**4.113** The Board of Management has assigned the plan administrator responsibilities for GLT&S to Morneau Sobeco. Morneau Sobeco maintains service and contribution data on each employee and prepares an annual administration report.

**4.114** The Minister of Finance has adopted the practice of advising the Board of Management on matters relating to trusteeship. The Treasury Division of the Department provides the necessary advice to the

Minister of Finance. The Division is responsible for monitoring and evaluating the investment managers and custodians of plan assets. It also has the responsibility to prepare the financial statements for the pension fund. The Division reviews the investment policies and proposes changes, where necessary.

## Investment policies should exist

**4.115** Our first criterion was:

*Appropriate investment policies and goals should be prepared and approved.*

***The governor's role in investment policy approval***

**4.116** In the case of GLT&S, the Board of Management, as governor, approved the investment policies and the choice of investment managers**.** The Board also has the power to make amendments subject to the collective agreement and the *Income Tax Act*.

**4.117** While we were pleased to see the governor taking a direct role in approving key decisions of the pension plan, the responsibility for doing so is not reflected in the plan document. We see this approval as an important aspect of the governor's responsibility which should be formalized to ensure that future actions are guided by these good practices.

***Review of the investment policy for the GLT&S Plan***

**4.118** The letter of agreement signed with each of the investment managers details the investment policies to be followed. The investment policies for the three managers are identical with the exception of the reference to portfolio diversification and asset allocation. Each manager is given unique instructions in these areas. Board of Management approved the investment policies on 17 December 1998.

**4.119** We reviewed the investment policies in place with the three managers for the GLT&S Plan. We examined the policies from the perspective of compliance with the industry best practices, and found them to be acceptable. The one exception we noted was a lack of consistency between the investment policies and the objective of the plan.

**4.120** The investment policies state that the long-term objective of the fund is to provide a long-term real rate of return equal to 3.75 percent over a period of five to ten years. There is no discussion within the policy or in any other information provided by the Treasury Division on how this measurement was decided upon.

**4.121** The purpose of the pension plan, as stated in the plan document, is "... to provide benefits to eligible employees in accordance with the specific terms and provisions." With this objective it would be reasonable to expect evidence to support the conclusion that a 3.75 percent long-term real rate of return is sufficient to meet the objective of the pension plan. Such documentation did not exist.

***Recommendations***

**4.122 We recommended that the governor's practice of approving major decisions of the plan be supported by requirements within the plan document.**

**4.123 We recommended there be a clear link between the objective of the pension plan and the long-term real rate of return objective as set in the investment policy.**

***Departmental response***

**4.124** *The Department will be taking steps to adopt the recommendations.*

***Conclusion***

**4.125** In general this criterion has been met. However we are concerned that the governor's current responsibilities are not recognized in the plan document. We also see the need for a better connection between the plan objective and the plan's long term rate of return.

## Investment policies should be regularly reviewed

**4.126** Our second criterion was:

> *Investment policies and goals should be reviewed on a regular basis and updated as required.*

**4.127** Each investment policy states: "This Policy will be reviewed annually by Treasury and Debt (Treasury Division) to determine whether amendments are required."

**4.128** We learned that there is no documented process or procedures in place to conduct this annual review. Treasury Division staff explained that their review is of a continuous nature as they monitor the reports prepared by the investment managers and review the performance reports that are prepared by an independent third party. In our opinion the monitoring and review of reports, by itself, does not address the need to ensure that the investment policy continues to be appropriate and to meet the objective of the pension plan.

**4.129** For some time the Department of Finance has been using the "actuarial valuation committee" to develop recommendations related to the actuarial valuations of pension plans. This committee consists of seven members and reports to the Minister of Finance.

**4.130** We examined the minutes of the committee meetings back to October 1996. We noted that on one occasion the committee devoted time to examining the impact that varying rates of return assumptions would have on the pension plans. By creating such information, the opportunity is presented to equate investment risk with rates of return and to examine the impact of these risks on the expected returns.

**4.131** If such an analysis were conducted on a more frequent basis, and the results were used by the Treasury Division to provide advice for the Board of Management, the Board, as governor, would be in a much better position to approve investment policy changes when called upon to do so.

*Recommendations*

**4.132 We recommended the Treasury Division document and implement procedures to be performed on an annual basis to ensure that the investment policies continue to be appropriate and to meet the objective of the pension plan.**

**4.133 The results of the annual review of investment policies should be documented and presented to the governor of the plan, along with any recommendations for changes in the investment policy.**

**4.134 We recommended the actuarial review committee be used by the governor to provide information that can be used to assist in making well-informed decisions on the investment policy of the GLT&S plan.**

*Departmental response*

**4.135** *The Department agrees that certain procedures can be improved and will undertake to review the necessary changes.*

*Conclusion*

**4.136** The Treasury Division does not have procedures in place to ensure an effective review of investment policies is conducted on an annual basis and, as a result, this criterion has not been met.

## Selection of investment managers

**4.137** Our third criterion was:

> *Selection criteria for investment managers should be clearly established and complied with.*

**4.138** The search that resulted in the hiring of the three existing investment managers saw the Treasury Division organize the process through the use of a search committee. The search committee made a recommendation to the Board of Management which made the final decision. Treasury Division staff were on the search committee which made the recommendation to the Board. Although the current plan document calls for the pension committee to be involved in the selection process, this was not a requirement at the time of the selection process in question.

**4.139** Although the investment policies do not specify the investment manager selection process, we examined documentation at the Treasury Division that explained how the search process was carried out.

**4.140** We were pleased with the selection process as it related to obtaining information from the managers and the role played by the selection committee. We were disappointed, however, that we were unable to obtain an explanation for the reasons behind the recommendation for the hiring of three managers or for the reasons to support the amount of the investment funds allocated to each of the investment managers.

**4.141** We also noticed that the draft investment policy was prepared after there had been a preliminary selection of investment managers. Since an investment policy sets out the different asset classes and the acceptable ranges for each, we would have expected to see the investment policy established before the commencement of a selection process. It would also have been valuable for decisions to have been made on the preference for speciality versus balanced investment managers and the desired number of investment managers.

***Recommendations***

**4.142 The plan document should clearly define the roles and responsibilities of all parties involved in the selection of investment managers.**

**4.143 The Treasury Division should use their current practices to help develop a policy outlining the process for selecting the investment managers. The process should include documenting appropriate criteria for the selection of investment managers.**

**4.144 We recommended that, in the future, before starting the selection process for investment manager(s), the investment policy be reviewed and updated if necessary, and decisions be made as to how many managers are to be hired and whether they will be specialized or balanced.**

***Departmental response***

**4.145** *The Department will be taking steps to improve documentation process.*

***Conclusion***

**4.146** This criterion has been partially met. Although we have seen evidence of some good practices in use for the selection of investment managers, we see the need for clarifying roles, formalizing practices and, in some cases, improving practices.

## Monitoring performance of investment managers

**4.147** Our fourth criterion was:

> *The investment manager's performance should be routinely monitored and evaluated with corrective action taken as required. Compliance with the plan's investment policies and goals should be monitored.*

**4.148** The Treasury Division has hired an independent firm to measure the performance of the three investment managers and the fund in total. The reports provide the rates of return, measure performance against benchmark indices and rank performance against other managers. The detailed reports are provided to the Treasury Division on a quarterly basis.

**4.149** On a quarterly basis the Treasury Division conducts steps to ensure the income and investments are recorded correctly in the reports provided to them by the investment managers.

**4.150** The Treasury Division also assesses managers by having periodic meetings. Investment policy requires the managers to meet with the Treasury Division at least annually. We reviewed evidence confirming that presentations were made to the pension committee while staff from the Treasury Division were in attendance.

**4.151** The foregoing practices are not supported by documented policy.

**4.152** The Treasury Division has recently drafted a document which it feels can be used to help determine if a manager should be retained. We reviewed the document and found that it covers most performance evaluation concerns. Some additional areas that should be considered are as follows:

- **Fee structure** - Regardless of the fee structure it is important that the fees continue to be competitive, after taking into consideration the investment managers' mandates. Reviewing this fee with the managers at the time of the annual meetings would help ensure it is still reasonable and appropriate.

- **Decision to retain managers** - The Treasury Division should consider the use of a checklist to outline the circumstances when the Treasury Division will start to monitor the manager more closely, when it will put the manager on a watch-list and when a manager will be removed from the watch-list. It would be appropriate in our opinion to communicate this checklist to the managers.

**4.153** We examined the 31 December 2000 quarterly report prepared by one of the investment managers. The purpose of our examination was to determine the extent of the manager's compliance with the investment policy.

**4.154** One of the findings from this review was that the investment in US and other international investments was over 24% of the total invested. The investment policy limits such investments to 20%. Another finding from this review was that the manager was reporting on only four of the five indices required by the policy. Information on these indices is needed for performance evaluation.

**4.155** Within the past year the Treasury Division started conducting procedures to ensure each manager complies with asset allocation and portfolio constraints. We were glad to see that the new procedures have been introduced, given that we encountered deficiencies in the one report we examined.

***Recommendations***

**4.156 The Treasury Division should develop and document a monitoring process so there is a commitment to ensure that each investment manager is complying with their prescribed mandate.**

**4.157 We recommended the draft of the process for evaluating managers be adopted and improvements be made in the areas of fee structure and retaining managers.**

**4.158 The manager reports should include a signed declaration from the manager stating that they have complied with the investment policy.**

**4.159 To complete the accountability cycle, the Treasury Division should present a formal report to the pension plan governor on at least an annual basis that documents the result of the work it has performed in monitoring and evaluating the performance of the managers.**

***Departmental response***

**4.160** *The Department will be taking steps to adopt the recommendations.*

***Conclusion***

**4.161** There are a number of policies and practices in existence which help to ensure there is a reliable process in place to monitor and evaluate the managers and to ensure compliance with the investment policy. There is a need, however, for documented policies and in some cases improvements to processes. As a result we conclude that the criteria has been partially met.

## Performance reporting

**4.162** Our fifth criterion was:

> *There should be an annual report produced that gives readers information to understand the plan and assess the performance of the pension plan.*

**4.163** The GLT&S publishes audited financial statements annually. There is no other annual reporting of significance. As a result there is a significant amount of information that is not presented to members. The following are examples of areas that could be covered in an annual report:

- the purpose of the plan;
- the plan’s goals, both long and short-term;
- the plan’s major activities or highlights for the year;
- actual results as compared to planned performance;
- disclosure of the total costs of administering the pension plan;
- information on the performance of the asset managers; and
- planned changes affecting plan assets and liabilities.

**4.164** The plan governor should have the responsibility to prepare and publish an annual report for the plan. Such an annual report would be made available to all contributors and pensioners.

***Recommendation***

**4.165 The plan governor should publish an annual report for this pension plan. The Province's annual report policy should be used as a guideline for the preparation of the report.**

***Departmental response***

**4.166** *The Department will be working with the Office of Human Resources and the Pension Committee to develop a useful annual report.*

***Conclusion***

**4.167** There is no annual report that gives readers information to understand and assess the performance of the pension plan. As a result this criterion has not been met.