Pension Risk Management: Administration Risks

September 01, 2016

Our Pension Alert series on risk management have discussed financial risks and investment risks. In this third issue, we discuss administration risks which may expose a plan administrator to law suits and regulatory proceedings, and provide our suggested strategies to reduce or address such risks.

Key Risk – Claims Arising From Breach of Duty of Care and Fiduciary Duties

Pension plan administration risks relate to the risks in administering a pension plan and administering and investing the pension fund.

A plan administrator is subject to the common law duty of care and fiduciary duties. Fiduciary duties include the duty to act in an even-handed manner in respect of plan beneficiaries and members (former and current). This may not be an easy task in some situations. In addition, all pension benefits standards legislation, federal and provincial, also imposes an elevated statutory standard of care which requires the plan administrator to not only use the knowledge and skills it possesses, but also the knowledge and skill that it ought to possess by its business or profession. Such fiduciary duties and standard of care apply to individuals acting as delegates of the plan administrator (e.g., human resources employees who are delegated with administrative tasks) and individual members of a pension committee which is the plan administrator.

The worst fears of a plan administrator are class actions instituted by plan members or beneficiaries for errors or omissions in plan administration arising from an alleged breach of duty of care or fiduciary duties. This is the key administrative risk.

Risk of Regulatory Action

The key responsibility of a plan administrator is to ensure that the plan and the pension fund are administered in accordance with the applicable pension benefits standards legislation. Most (if not all) pension plans are registered under the *Income Tax Act* (Canada) ("ITA"). In order to maintain the registration, the plan is required to be administered in accordance with the provisions in the ITA which are applicable to a "registered pension plan".

The pension benefits standards legislation imposes numerous statutory obligations on the plan administrator, including filing and reporting requirements and disclosure requirements with prescribed time-frames and, in some cases, with prescribed forms and/or contents. It is quite possible for a plan administrator to miss a prescribed due date, omit certain prescribed contents or neglect to use a prescribed form.

In addition to statutory obligations, the pension regulators have issued guidelines and policies setting out their expectations of a plan administrator in discharging its duties. Regulatory bodies like the Canadian Association of Pension Supervisory Authorities (an association of pension supervisory authorities) has also issued guidelines for plan administration. Although such policies and guidelines do not have the force of law, they represent industry best practices which are likely used by the court as yardsticks in measuring whether the plan administrator has met the standard of care and discharged its fiduciary duties if there is a dispute before the court.

The complex and detailed statutory and regulatory requirements expose a plan administrator to a risk of committing a technical non-compliance. The regulator may institute proceedings to order compliance. A non-compliance is also a statutory offence. On conviction, penalties (a fine) will be imposed on the plan administrator and individuals (e.g., directors, officers, agents) who permit, participate in or acquiesce in the commission of the offence. If such non-compliance causes losses to plan members and beneficiaries, the plan administrator will likely have to face lawsuits instituted by them.

Risk of Administrative Errors

Obviously, a plan administrator needs to administer the plan according to its terms which requires the plan administrator to interpret plan language. Plan interpretation is not always an easy task. Plan terms can be complicated, particularly if the plan has been in existence for a long time with numerous historical amendments or if the plan covers members who are subject to the pension benefits standards legislation of different Canadian jurisdictions. Such multi-jurisdictional issues are to a certain extent addressed, but not completely removed, by the Agreement respecting Multi-Jurisdictional Pension Plans.

Here are some examples of typical administrative errors: failure to enroll employees after they have satisfied the membership eligibility requirements, making benefits payments to a wrong beneficiary (e.g., "spouses" with competing claims), using defective forms (e.g., defective form of spousal waiver), miscalculation of benefits resulting in overpayment or underpayment of benefits and miscommunication with plan members or beneficiaries.

Administrative errors do not only expose the plan administrator to claims from plan members and beneficiaries. If the errors arise from the failure to administer the plan according to the plan terms as registered with the Canada Revenue Agency ("CRA"), there is a risk that CRA may revoke the plan registration with adverse tax consequences to the plan sponsor and members.

"Fixing" an error can be difficult, particularly if the error was made a long time ago and affects a large group of employees and/or former employees. Sometimes the

rectification requires court approval. It is advisable to seek professional assistance before embarking on any action to "fix" an error.

Risks Arising from Delegation Without Proper "Control" Mechanism

In view of the complex technical statutory requirements and administrative tasks, a plan administrator will likely desire to delegate some or all administrative tasks internally or externally to a service provider at some point in time during the course of plan administration. If a plan administrator does not have the required knowledge and skill to administer a plan, it must either acquire such knowledge and skill or delegate the tasks to a service provider that has the required knowledge and skill.

All pension benefits standards legislation permits a plan administrator to delegate almost all administrative tasks but it also requires the plan administrator to exercise the duty of care in selecting the delegates and to supervise the performance of the delegates. The plan administrator will not be "off the hook" by delegating its responsibilities. It can remain liable for the errors and omissions of its delegates.

A common difficulty in delegation to an external service provider is the negotiation of the service contract (particularly if it is a small pension plan) because of the unequal bargaining power. Usually the service provider will ask the administrator to sign its template service contract which typically favours the service provider. It is also common for a service provider to include a monetary limit on its liability. As a result, the administrator has limited recourse against the service provider when sued by plan members or beneficiaries for errors made by the service provider.

Cyber and Privacy Risks

Most plan administrators and their service providers have embraced advanced computer technology one way or the other in plan administration. Electronic means are used in member communications and plan data storage. Plan data includes sensitive information such as social insurance numbers, dates of birth, banking information and details about family members.

Plan administrators have to comply with e-commerce legislation and industry guidelines in using technology in plan administration. Regulators do not object to the use of electronic means in plan administration. Use of technology is definitely part of the modernization of the pension system. However, the use of technology is coupled with cyber risk and data management issues. A cyber attack or the inadvertence of in-house personnel or external service providers could result in wrongful access to plan data and exposing the plan administrator to claims for breach of privacy law.

Strategies to Minimize Administration Risks

A plan administrator is liable to plan members and beneficiaries for an error made in plan administration if it is proved that the administrator fails to meet the standard of care or discharge its fiduciary duties. In addition, the plan administrator may be subject to penalties for failing to comply with the requirements under the pension benefits standards legislation. To minimize the risks, plan administrators should exercise due diligence in all facets of plan administration, which emphasizes the importance of having a good governance structure, a deliberate decision-making process, appropriate

documentation and recordkeeping and the monitoring of plan administration. It is also advisable for the plan administrator to document the process for its due diligence defence.

Below is a list of recommended strategies to address or minimize different administrative risks.

- Set up a sound and effective governance system with a regular periodic review of its appropriateness.
- Maintain a good checklist of all statutory and regulatory reporting, filing and other requirements, the prescribed time-frames and the individuals having responsibility for compliance with each of such requirements.
- Maintain a sound policy and practice that safeguards plan data.
- Select appropriate service providers with a contract that contains reasonable and workable terms with as strong a protection as possible (e.g., regular reporting, compliance certification, service standards, a high standard of care provision, error rectification process and a strong indemnity).
- Keep proper records of the decision-making process.
- Designate specific individuals to handle employees' enquiries and complaints, keep proper records of enquiries and complaints and responses and actions in response.
- Seek professional advice when appropriate.

A plan administrator may also wish to perform compliance audits on a periodic basis to confirm that the plan administration is in compliance with legal requirements. The scope of the audit varies. It can range from an audit of a specific aspect of plan administration (e.g., plan fund investment) or a comprehensive audit (e.g., the entire governance and administration structure). The administrator needs to bear in mind that any gaps or concerns revealed by the audit need to be properly addressed; otherwise it will likely work against the administrator as evidence of the administrator failing to properly administer the plan.

Even with the greatest caution, sometimes an error or member's complaint or law suit is not avoidable. It is highly desirable for a plan administrator to review the situation with professional advice before responding or taking any action. Sometimes a "quick" fix without considering its implications may result in more problems than the problem to be fixed.

Liability Insurance and Other Protection

When a plan administrator suffers a loss in performing its duties in plan administration, it can claim reimbursement by the pension fund. This does not offer "bullet-proof" protection to the plan administrator. The plan administrator may not be able to claim reimbursement from the pension fund if the loss arises from its wrongful act or omission. Sometimes there is an indemnification agreement of the employer in favour of the administrator and its delegates. The employer's indemnification is not meaningful if the employer is the administrator. The effectiveness of the indemnification also depends on the financial condition of the employer.

A plan administrator (including an employer wearing the plan administrator's hat) may wish to consider purchasing fiduciary liability insurance. The scope of coverage varies.

It can cover administrative errors, claims brought by plan beneficiaries, claims brought by regulators, etc. Insurance premiums and deductibles may be paid from the pension fund as an administrative expense, depending on the plan terms.

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