Marris Miller

Leveraging the Law: For Worse or for Better?

The Pension Papers™

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So how can pension managers best use the law to create best practice frameworks for pension strategies?

In this paper, we'll look at why the law is challenging to navigate when it comes to pension management, but why shifting towards leadership allows businesses to leverage the law in a positive way. How can we best use the law to create hope for our collective futures? We'll explore why business leaders need to create their own sustainable pension plans, relying on their own ideals and values.

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In Canada, the Wage Earner Protection Program (WEPP) provides for the payment of outstanding eligible wages to individuals whose employer is bankrupt or subject to a receivership. It's the last port of call for workers who ought to have received a pension, paying out a maximum of $7,150.

There is, however, no legal guarantee to an individual receiving her pension from a company if that company collapses. The same is true for the public sector. As Elizabeth Shilton's book investigating the legal tenets of pensions in Canada, Empty Promises, suggests as well, even government and non-profit employers have taken up pension restructuring as a key strategy for managing the impact of austerity budgets and revenue losses. This is achieved through legal finagling that often leaves both workers and organizational leaders worse off over the long term.[1]

For some companies, Shilton explains, this has led to the conclusion that they ought to step out of pension provision altogether, leaving retirement choices up to their employees to manage on their own. But this isn't necessarily in the best interests of companies, and it certainly isn't in the best interest of the economy: in a market economy like ours, changes in what we know as the 'nuclear family' and the 'extended family' mean that many of the most vulnerable in our society aren't getting the support they need in old age, which actually creates more of a financial burden for families.[2] This, in turn, puts pressure on the government and on taxation to provide for our elders, and it decreases consumer spending in other areas. Cutting out pensions is not a solution that's going to help build our economy, or our business community, then.

[1] Shilton, E. (2016). Empty Promises: Why Workplace Pension Law Doesn't Deliver Pensions. McGill-Queen's Press-MQUP.
[2] Davis, E. P., & Lastra, R. M. (2016). Pension provision, care and dignity in old age: legal and economic issues. Brunel Economics and Finance Working Paper (16-06).

So how can pension managers best use the law to create best practice frameworks for pension strategies?

In this paper, we'll look at why the law is challenging to navigate when it comes to pension management, but why shifting towards leadership allows businesses to leverage the law in a positive way. At the same time, while some lawyers who think in business terms have helped their clients greatly in making good decisions, this isn't always the case. How can we best use the law to create hope for our collective futures? We'll explore why business leaders need to create their own sustainable pension plans, relying on their own ideals and values.

Current Legal Standards In Place

The Supreme Court of Canada set the most recent standard for employment pension trusts in 1994 in a case known as Schmidt v. Air Products.

In this case, the company, Air Products, a world-leading industrial gases company based in Canada, merged two defined benefit pension plans as a means to decrease administration costs and simplify work around pension management. As a result, a surplus was created, and the company claimed that it was entitled to this. The plan members, however, decided to take Air Products to court, arguing that they were the ones who were entitled to the surplus.

The Court ruled against Air Products, and stated that the creation of a pension plan constitutes a public trust, wherein there is a deep responsibility to the employees who have created the means by which the funds were collected in the first place, even if the employer contributes to those funds. Where surplus is part of the trust, therefore, the Court set the standard that the employer will be entitled to it only if there are three standards met:

(i) the employer was made a beneficiary of the trust from the outset;
(ii) the employer reserved a power to revoke the trust when it was established; or
(iii) the doctrine of the resulting trust is applicable.

In this way, the Court has tried to ensure that employees are protected from employer self-interest, especially given their deep pockets in comparison to the resources and power that

the average employee has. As noted by researchers, employers sometimes use and hoard excess cash flows, including pension monies, to shore up the business rather than its pension plan members because returns earned on pension plan assets may be more attractive than other investment opportunities, leading to more investment in pension plans.[3] While this is not necessarily always a bad thing, it isn't always truly legal, given the standards of the Court.

This may be why the promise of the Schmidt v. Air Products ruling, however, Shilton explains, has not had the effects that the Court may have imagined. As she writes,

> Since Schmidt, the Court has moved away from a conception of trust law as a fetter on employer power towards a flexible conception in which employer trust obligations are defined almost entirely by the terms of pension documents which those employers have themselves drafted. In the hands of Canadian courts, trust law has failed to operate as an independent source of rights for plan beneficiaries; instead, it has empowered employers to frame and administer plans in accordance with their own interests, even when those interests conflict with those of employee plan members. The Court's approach reflects its belief that employer control of pension plans and pension rights is fundamental to the survival of a voluntary employment pension system.[4]

In other words, the impetus of the Court to protect the rights of employees has had the effect of incentivizing companies to create different pension plans, such as the move away from DB plans towards DC and RRSP plans, so that their responsibility towards employees is lessened.

This may be upholding the letter of the law, but not the intention of it.

Does this mean that companies are in the clear, not only ethically, but legally? **The answer, according to researchers and legal scholars, is no.**

[3] Ballester, M., Fried, D., & Livnat, J. (2002). Pension plan contributions, free cash flows and financial slack. Unpublished working paper, New York University.
[4] Shilton, E. (2011). Employee Pension Rights and the False Promise of Trust Law. Dalhousie LJ, 34, 81.

As a result of this kind of legal precedent as well as the demographic and economic changes in our midst, however, a lot has recently shifted. Pensions used to generate record returns in the stock market, and therefore companies had the ability to play with surplus funds in a way that they cannot now. Employers were putting extra money in pension funds for tax-free returns. Now, most plans are in huge deficit, and it's the opposite that the employers are concerned about: that they will be asked to put more money in, and that employers are struggling to put in their minimum required contributions.

And, as the legal literature suggests, when there is a perceived hardship in place, many companies will try to look for loopholes that may or may not be fully legal.

Legality And Justice: A Difference

All components of traditional forms of law are, according to scholars, likely to be based on what is known as rational choice theory.[5]

Rational choice theory posits that there is an underlying rational process that each citizen or corporate leader will think through before deciding on their best course of action, which will either increase their success or reduce their risk. The rational choice can either be focused on short term or long term goals, but the end result is that people will choose to help themselves in whatever way seems the most rational. A court's job is to mitigate the instances in which people act irrationally.

The fundamental problem presented in Schmidt, and the reason for the Court's intervention, is that corporations rarely act according to rational choice, or at least they limit their rationality to specific decisions, such as those that create access to capital. This is not a long term, sustainable approach, as Schmidt states, because companies that do not act in the public trust will alienate not only their employees but their customers.

The American poet Archibald MacLeish once said that the purpose of the law is not only justice, but also to make sense of the confusion of life, so that we might reduce it to a place of order but also to give it possibility, scope, as well as essential human dignity. Over time, companies must recognize that the legal, policy and economic issues associated with

[5] Braithwaite, J. (2002). Restorative Justice and Responsive Regulation. New York: Oxford University Press.

pension provision, care and dignity in old age are fundamental challenges for the future of our society, and therefore for the future of their survival and success. [6]

That's why the law, when it comes to governance of corporate pensions, is beginning to shift towards new definitions of responsibility linked to justice.
What does this mean?

There is a difference between a focus on the law and a focus on justice.

Under the law, employers have considerable discretion and control in pension design and administration. Under new standards of social justice, pensions will likely need to respond to the changing workplace, the shift in our global demographics, and, in this way, directly address the needs and interests of those who are retiring.

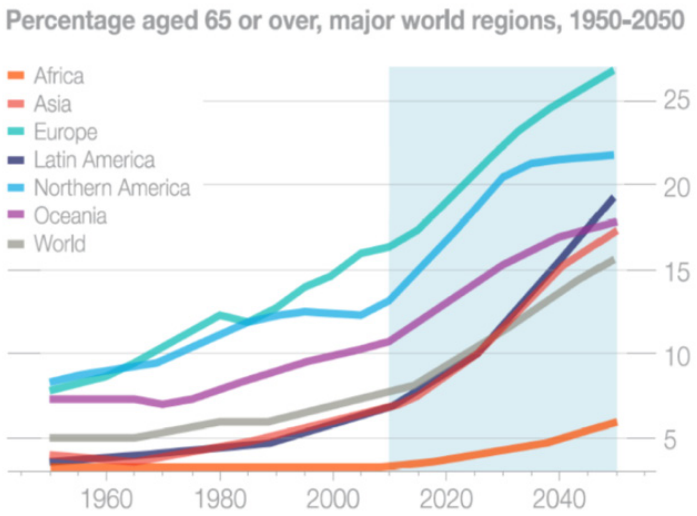
The Rise Of Generational Fairness Standards

Legal pundits suggest that generational fairness is actually going to be a part of how they negotiate terms in the coming years.

What is generational fairness?

As we've discussed in previous papers, we're at a point in history where more people are retiring than moving into the employment market, as detailed in the graph below.

Graph 1: Global demographic changes, as of 2012 (Source: United Nations)



[6] Zhou, D. (2016). Re Indalex: The Confluence of Pension, Insolvency, and Fiduciary Law. Dalhousie J. Legal Stud., 25, 137.

People who have worked traditional jobs and are currently in the process of retiring are therefore putting a higher level of pressure on funds that were originally designed for a much higher level of employee input over courses of generations, and, as we've discussed before, this has put many DB plans at risk, forcing companies to react quickly and sometimes failing to a spectacular level, such as in the example of Sears.

But there is, perhaps, an even greater cascade of risks that can affect pensions at a number of different levels.

At the heart of this question is asset and liability mismatch, states the literature on the subject, which leads to increased risk.[7]

> The issue is whether the assets held are too volatile for the time profile of payments, thus generating excessive risk especially for members about to retire (assuming pension payments have priority), or alternatively the fund may have shorter maturity assets than liabilities, giving rise to reinvestment risk. Fair value accounting has made for greater volatility of balance sheets as a result of mismatch. Deficits might give rise to a search for excessive yield to make up losses due to mismatch, leading to credit risk.

The result of this is that many country governments are starting to impose regulations on corporations. This has been happening in order to curtail those leadership decisions that have been put into place to ensure that companies have been working under the letter of the law rather than aligned with fundamental justice and the kind of trust that the Supreme Court of Canada has envisioned.

This effect is only beginning to take place, but global leaders ought to expect more.

More and more, lawyers state, international standards set by the international standards of social security set by the International Labour Organisation (ILO) and the Council of Europe will affect global multinationals' pension processes, and trickle down to smaller businesses.[8]

[7] Davis & Lastra, 2016, p. 8.
[8] Hohnerlein, E. M. (2019). Pension indexation for retirees revisited–Normative patterns and legal standards. Global Social Policy, 1468018119842028.

Leadership And Fiduciary Duty: The New Legal Standards For Pensions

Businesses have to show real leadership in creating the right pensions based on a commitment to public trust, or they can be legally liable.

For Canadians, how these changes are showing up in our courts is a recent set of decisions that suggest that companies owe a fiduciary duty to pension plan members and beneficiaries to act in their best interests, knowing that the pension is the de facto property of the plan members, not the company.[9]

Acting in the best interests of plan members is a complex challenge, however. Managers, as agents of the shareholders in a company, have a fiduciary duty to use corporate resources to profit maximize. There are flaws in this, however, from a legal point of view as both employees and communities have an arguably larger 'investment' in the firm even if it is an indirect or non-financial one. As agents of the company, managers have wide discretion to pursue a range of ends, and must recognize that, in terms of principles, shareholders may want more than profit maximization, especially if the management of employees constitute a significant risk.

This is where corporate social responsibility (CSR) comes into play.

There are three generally accepted principles when it comes to CSR, which include economic security, human and labour rights, and environmental preservation. As noted in the literature, however, CSR can take "many different forms and is expressed in numerous ways, varying across wider cultural contexts as well as between individual organizations. A multiplicity of actors cultivating and influencing the field results in diverse imagery associated with the notion of CSR." [10] In other words, even though this is a concept that, as explained in the literature, has been around since the 1970s in business, its conceptualization is still unclear. [11] The reason that this is the case is that, as Milton Friedman once argued, the role of a business was believed to be to make money and specifically profits, so that more people

[9] Zhou, 2016, p. 149.
[10] Höllerer, M. (2012). Between creed, rhetoric façade, and disregard: Dissemination and theorization of corporate social responsibility in Austria. Frankfurt aM: Peter Lang GmbH, Internationaler Verlag der Wissenschaften.
[11] Bosch-Badia, M. T., Montllor-Serrats, J., & Tarrazon, M. A. (2013). Corporate social responsibility from Friedman to Porter and Kramer. Theoretical Economics Letters, 3(03), 11.

would be employed and therefore more of society would be secure. Nonetheless, what we have seen since that time is that a laissez-faire attitude towards CSR has led to all matter of business-led social failures, from the rampant overuse of resources to sweatshops to, as we are now seeing with clarity, the challenges that we are facing with pension management.

To this end, modern definitions of CSR are now linked to the idea of value creation rather than profitability.[12]

For instance, the implementation of labour rights which require a company to pay their workers fair wages, or provides them with a pension that is sustainable and trustworthy directly affects the economy of the countries in which they work. The more that companies adhere to these standards, the higher the quality of life for more people, and, additionally, the more likely that those people will become or be maintained as their consumers. Socially, upholding the human right to work without the fear of aging out of the workforce is pertinent to CSR and to the firm itself, because people cannot be productive, and therefore serve the company's interests, if they are prevented from feeling confident and supported at work.

All in all, therefore, the overarching aims of building societal welfare can make corporations more successful as well. This means that, from a legal perspective, companies that use CSR are those that move one step further than what is generally required by the law. For example, the European Economic Commission defines CSR "as a template used by corporations – on a strictly voluntary basis, moving beyond mere compliance with legal requirements and market expectations – in order to integrate various social issues, environmental concerns, and stakeholder interest."[13] What this suggests is that the law does not necessarily have an effect on CSR viability, but if there is a clear breach, then the law will intervene. Companies can, in this way, operate within the law without having a clear and implemented CSR plan in place, which means that there are still many grey areas in which companies may choose to modify their activities to either feed their perceived need for profits, or engage in positive and long term thinking about their role in broader society over the course of their market involvement. [14]

[12] Bosch-Badia, Montllor-Serrats, & Tarrazon, 2013.
[13] Höllerer, 2012, p. 31.
[14] Williams, Cynthia A. (2016). Corporate Social Responsibility and Corporate Governance. Articles & Book Chapters Paper 1784.

The impact of corporations on human rights is, even so, critical to the way in which people are protected at work and in the community, and these impacts have increased as the economic and political power of corporations has grown. In recent years, corporations have been called out to mitigate the growing need to be a respectable corporate citizen which includes acknowledging the need for respecting the human rights of those who are affected by the corporation's actions, especially as we see the degradation of pensions coming to light in the Canadian legal system.

At the same time, however, corporations are often deeply unaware of the ways in which these challenges are taking place, and how their decisions are affecting the community and the economy in ways that actually increase their risk. In fact, "the complex realities facing corporate decision makers will often necessitate making decisions that have potential impacts on many stakeholders including employees, consumers, suppliers, debt holders, option holders, governments, business partners, and local communities."[15] By placing the focus on one kind of fiduciary duty over another, this risk increases. Even though company leaders seem to think that ignoring fundamental justice issues is an informed risk they are willing to take, what is clear is that this is an emerging issue in the courts.

Balancing The Risk, Making The Ethical Choice

What all of this means is that, for those running businesses, leadership decisions need to incorporate new definitions of fiduciary duty and the public trust that take into account both local and global ideals, even if they are nowhere near insolvency.

The standards are changing, and true leaders will become aware of how they can take a role in making things right, and will allow changes to take place so that the ideal of fundamental justice is embodied in their pension planning strategies. In a world where rapid changes are taking place, of course this means that pensions have to be flexible. There may be difficulty in creating a plan that aligns with the DB standards of the 1950s, for example.

But there is room for creativity.

[15] Williams, C. A., & Conley, J. M. (2005). Is there an emerging fiduciary duty to consider human rights. U. Cin. L. Rev., p. 76.

The law says that company leaders also need to balance the role of an employer and the role of an administrator in respect of a pension plan. This means that leaders have to make some serious decisions about how they will resolve potential conflicts of interests and opportunities to build positive outcomes for their pension plans. Employers can begin with a few key approaches.

- **Transparency.** Be clear about what you want to achieve and how you are going to see your pension plan through over time. Ontario's risk-based regulatory framework provides hope for the future, for example. Under this approach, the focus is on providing transparency above everything else, in order to protect employees and their pension plans and to provide clarity to businesses about what is expected and how they can be supported.

- **Combine different pensions together.** The OECD has suggested that making pensions more sustainable means looking at a variety of options and bringing them together, either through employee choices or a varying-source portfolio. Combining funded and pay-as-you-go pensions, automatic mechanisms, and a strong safety net for pensioners improves retirement outcomes.

- **Consider (and critically assess) shared investment options.** The law is changing to give pensions more flexibility in terms of where they are housed to promote sustainable pension design for both employers and employees over the long term. But some flexible plans need critical thinking before implementation. The Colleges of Applied Arts and Technology (CAAT) Pension Plan allows private employers to join this shared risk plan, and some employers may find this easier and more flexible for their workplaces, but how big can it grow, and how will the plan sustain its returns?

- **Increase employees' knowledge of their pensions, and of the law.** We have recommended this before, but it bears repeating. Financial education can result in better retirement outcomes, given that low levels of financial knowledge and behavioural biases can lead people to make unsuitable decisions for retirement, but the law is increasingly asking employers to take employee education seriously.

- **Become your own devil's advocate.** In some countries, such as the UK, tools and training for pension trustees are readily available, but the same is not true here. Carefully consider, and get a legal or consulting opinion on your risks and what to do when the future does not happen as expected. Do this ahead of the game so that you're always prepared to defend your position. Self-criticism will help you create the right checks and balance going forward.

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