Conversion

A bulletin designed to assist in the understanding of the requirements of *The Pension Benefits Act, 1992* respecting the conversion of defined benefit provisions to defined contribution provisions.

FCAA
Financial and Consumer Affairs Authority

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CONVERSION OF A DEFINED BENEFIT PLAN TO A DEFINED CONTRIBUTION PLAN

Introduction

The conversion of a defined benefit plan to a defined contribution plan is a plan amendment. In accordance with subsection 19(3) of *The Pension Benefits Act, 1992* (the Act), an amendment may not reduce a person's benefit entitlements accrued prior to the effective date of the amendment. The conversion process, therefore, must ensure that the value of an individual's accrued benefit is preserved.

Generally, two approaches are taken on plan conversion. The first approach is to make the pension plan defined contribution for future service only, and to maintain accrued defined benefit entitlements to the date of the amendment as a liability under the plan. The second method is to calculate the commuted value of each individual's accrued benefit and then to transfer that commuted value to the member's account under the defined contribution plan.

The first method requires a more complex plan document and may be a challenge to administer, as both types of benefits must be covered. Also, the funding standards associated with a defined benefit provision continue to apply. Under the second method, a valuation is required at the time that the plan is amended. However, further valuations are not required, as the plan becomes purely a defined contribution plan.

This bulletin has no legal authority. The Act and the Regulations should be used to determine specific requirements.

The Conversion Process

Documents to be Filed

The following documents must be filed with the Pensions Division in order to convert a defined benefit plan to a defined contribution plan:

1. a plan amendment or restated plan text and any related board resolution;
2. any revised or additional investment documents;
3. an actuarial valuation, or where defined benefits are being preserved, a cost certificate illustrating the change in costs with respect to those benefits;
4. confirmation that the change in plan design, and its implications for members have been clearly explained to plan members; and
5. a copy of the revised employee booklet and any other information relating to the change that has been provided to members.

Plan Amendments

The revised plan document must meet the requirements of the Act and Regulations with respect to defined contribution plans. If accrued defined benefits are being preserved, it must also meet all of the requirements of the Act and Regulations respecting defined benefit plans. If defined benefits are being commuted, recognition of the crediting of members' accounts with these cash values must be included in the plan. For ease of reference, a listing of defined benefit members and either their accrued monthly pension or the commuted value of their pension, as applicable, may be appended to the amended or restated plan text.

Entitlements to benefits must also be preserved. Vesting with respect to benefits accrued prior to the plan amendment must be at least as favourable as that in effect prior to the amendment. Early retirement and survivor benefits also must be preserved.

Investment Documents

If the accrued defined benefits are being maintained, a separate trust or insurance policy may be set up to hold the funds. If this is done, then this revised trust or policy must be filed with the Pensions Division. Also, any changes in fund holder related to the revised defined contribution benefits must be filed for registration.

Plans are required to establish a written statement of investment policies and procedures. The administrator must ensure that the investment statement is reviewed on conversion for its appropriateness to a defined contribution plan.

The Actuarial Valuation

If the accrued defined benefits are being preserved, a full valuation is not required. An updated cost certificate is required. Triennial actuarial valuations and cost certificates will continue to be required.

If the defined benefits are being commuted, an actuarial valuation must be filed on conversion. The valuation report should include the following items:

1. The basis used to determine the value of the defined benefits. This basis may not result in the value of any individual member's benefit being less than that which would be determined pursuant to the Canadian Institute of Actuaries' Recommendations for the Computation of Transfer Values From Registered Pension Plans.
2. The value of any special or ancillary benefits must be included in determining the value of an individual's benefits. This includes, for those who do not already qualify for a given special feature, an assumption as to the probability of their ultimately qualifying for the benefit if the plan had remained unchanged. The valuation report must list all plan special features and include a statement from the actuary that the appropriate value for these benefits has been included for each member.
3. Where the plan requires it, a projection of salary must be included. The inclusion of this assumption is plan specific. If there is any doubt as to whether or not to include projections, the Pensions Division should be contacted before proceeding with the valuation. Appropriate allowance may be made for the probability of termination or death prior to retirement. If the plan requires a projection of salary, the plan cannot be amended to eliminate or reduce such a benefit as it has accrued to the member.
4. A list of the members, including the value of their contributions, the commuted value of their respective benefits and any excess contributions, must form part of the report.

Special Considerations

Option to Purchase Annuities

The conversion of a defined benefit plan to a defined contribution plan transfers the risk previously assumed by the employer to the member. Because of this, and because older members would have less time to recover from adverse market effects, all plan members who are eligible for early retirement must be given the option of purchasing a deferred life annuity equal to their accrued defined benefit under the plan. The plan administrator may wish to extend this option to all plan members.

Treatment of Surplus

The treatment of surplus assets will be determined by plan provisions. A refund of surplus to the employer or the use of surplus to make future employer contributions to the defined contribution plan may occur, but only if the plan so permits. All legislative requirements for an ongoing surplus refund or contribution holiday must, however, be met before any refund or holiday may occur.

Alternately, the surplus may be allocated to the member's accounts. If this latter option is taken, the method of allocation must be filed with and approved by the superintendent. The allocation method may be included in the valuation report on conversion or may be done separately.

Insufficiency of Assets

Where a valuation indicates that assets are insufficient to fund the accrued defined benefit liabilities, the employer may either make a lump sum payment to immediately fund the entire solvency deficiency, or arrange to fund the solvency deficiency over a period not exceeding 5 years. If the second option is chosen, details of the funding arrangements should be discussed with the Pensions Division before any action is taken.

Treatment of Pensioners and Deferred Members

A defined benefit plan which has been paying pensions from the fund and holding the benefits of deferred vested members either may continue to hold the funds and make the payments, or move them to an outside vehicle. If the former is chosen, triennial valuations will continue to be required as the fund still has defined benefits for which a deficiency could arise. If these liabilities are to be removed from the fund, individual annuities must be purchased for pensioners. This may also be done for deferred vested members, though it may be preferable to first provide them with the option to transfer their benefits to a locked-in retirement account. Please note that a group annuity contract does not serve to remove these members from the fund unless the annuity contract specifically guarantees to insure all solvency deficiencies which could arise in the future.

Employee Excess Contributions

Where benefits are being converted under a contributory defined benefit plan, member excess contributions must be determined at the date of conversion. The member may then be given the option of a cash refund or a transfer of those contributions to the additional voluntary contribution account, if any, of the member under the defined contribution plan.

Disclosure

As noted earlier, changing a pension plan from defined benefit to defined contribution transfers the risks of the pension plan from the employer to the plan member. Therefore, members must fully understand how the change affects them. An explanation of the plan changes and the treatment of the accrued defined benefit must be provided to each affected member. It may be advisable to have each member sign a form stating the changes are understood and acceptable. This would seem particularly relevant if the option to purchase deferred annuities is not being given to all members.

Timing

Conversion of a plan from defined benefit to defined contribution is an amendment and as such the relevant documents must be submitted to the Pensions Division within 60 days after the amendment is made. If this deadline cannot be met, arrangements should be made with the Pensions Division to extend the required period for filing documents.

Contact Us

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