

Office of the Superintendent - Pension Commission

Policy Bulletin #8

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Conversion of a Defined Benefit Plan to a Defined Contribution Plan

Reference: *The Pension Benefits Act Subsection 26(5) and the Pension Benefits Regulation Subsections 2.7(1), 2.7(2) and 4.30(2) and Section 5.12*

The conversion of a defined benefit plan to a defined contribution plan is an amendment to the plan and is subject to subsection 26(5) of *The Pension Benefits Act* (Act). Subsection 26(5) requires that any amendment of a pension plan shall not reduce the pension or pension benefit credits, of any person, accrued prior to the effective date of the amendment. The objective of the conversion process is therefore to ensure that the value of the person's accrued benefits at the conversion date is preserved.

Two approaches are used for this purpose. The first approach involves accruing benefits on a defined contribution basis for future service only, and maintaining the accrued defined benefit entitlement to the date of amendment or conversion as a liability under the plan. Funding requirements as set out under the Act and Pension Benefits Regulation (regulation) continue to apply with respect to the defined benefit portion of the plan.

The second approach is to calculate the commuted value of the defined benefit entitlement of each member of the pension plan and then establish the commuted value as the member's initial account balance under the defined contribution plan. While an actuarial valuation is required as of the date of amendment or conversion, on-going valuations are not required following the date of amendment as the plan is now purely a defined contribution plan.

THE CONVERSION PROCESS

Documents to be Filed

The following documents must be filed with the Office of the Superintendent - Pension Commission (OSPC) within 60 days after the amendment is made in order to convert a defined benefit plan to a defined contribution plan:

1. certified copy of related board resolution;
2. certified copy of any revised or additional investment documents;
3. confirmation that the change in plan design, and its implications for members have been clearly explained to plan members; and
4. a copy of the revised employee booklet and any other information relating to the change that has been provided to members.

An actuarial valuation, or where defined benefits are being preserved, a cost certificate illustrating the change in costs with respect to those benefits must be filed within 120 days after the amendment is made.

Plan Amendments

The revised plan document must meet the requirements of the Act and regulation with respect to defined contribution pension plans. If accrued defined benefits are being preserved, it must also meet all of the requirements of the Act and regulation respecting defined benefit plans. If defined benefits are being commuted, recognition of the credit of member's 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, if applicable, may be appended to the amended or restated plan text.

If defined benefits are being maintained any early retirement and survivor benefits must be preserved.

Funding Agreement

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 OSPC. Also, any changes in fund holder related to the revised defined contribution benefits must be filed with the OSPC.

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 on the conversion must be filed. The valuation report should include the following:

1. The basis used to determine the value of the defined benefits. This basis may not result in the value of any member's benefit being less than that which would be determined pursuant to the Canadian Institute of Actuaries, "Revised Standards of Practice for Determining Pension Commuted Values (Section 3800)".
2. The value of any special or ancillary benefits must be included in determining the value of an individual's benefits once he or she has met all the eligibility requirements under the pension plan necessary to exercise the right to receive the benefit. 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 has 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. Please refer to OSPC Policy Bulletin 7 Determination and Transfer of Commuted Values for additional information regarding the determination of commuted values.
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 OSPC should be contacted before proceeding with the valuation. Appropriate allowances may be made for portability on 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. Due to 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 pension 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 service 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. Please refer to the OSPC Policy Bulletin 6 Payment of Surplus Assets from Pension Plans.

Alternatively, the surplus may be allocated to the members' accounts. If this latter option is taken, the method of allocation must be filed with, and approved by the OSPC. The allocation method which should be equitable may be included in the valuation report on conversion or may be done separately.

Insufficiency of Assets

Where a valuation indicated 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 deficiency, or arrange to fund the deficiency over a period not exceeding 5 years. If the second option is chosen, details of the funding agreement should be discussed with the OSPC before any action is taken.

While the accrued defined benefit entitlement of members are being maintained as a liability under the defined benefit plan, the transfer deficiency provisions of the legislation continue to apply.

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 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 the plan sponsor may wish to give consideration to first providing 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 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 employer may then choose to extend to all plan members the option of a cash refund or transfer of the excess contributions, or a transfer of those contributions to the additional voluntary contribution account of the member under the defined contribution plan, if available.

Disclosure

Within 60 days after an amendment affecting the rights, benefits or obligations of members is made to a plan, the administrator must give written notice of the amendment to all affected members and other beneficiaries and any bargaining agent representing affected members. The notice must contain a summary of the amendment and the administrator's contact information.

As noted above, changing a pension plan from defined benefit to defined contribution transfers the risks of the pension plan from the employer to the plan member. For this reason, each affected member and other beneficiaries must be provided with sufficient information to fully understand how the conversion affects their accrued defined benefits. It may be advisable to have each plan member sign a form stating that the changes are understood and accepted. This would seem particularly relevant if this option to purchase deferred annuities is not being given to all members.

If you have any questions regarding this bulletin you may contact us at:

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**** Available in English Only ****

This bulletin has no legal authority. The Pension Benefits Act of Manitoba and the Pension Benefits Regulation should be used to determine specific requirements.