

## Policy Bulletin #15

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# Conversion of a Defined Contribution Provision to a Defined Benefit Provision

This Policy Bulletin sets out how the office of the Alberta Superintendent of Financial Institutions (ASFI), Alberta Finance, will interpret and apply the Employment Pension Plans Act (the "Act") and accompanying Employment Pension Plans Regulation (the "Regulation") with respect to amendments involving conversions from defined contribution provisions to defined benefit provisions.

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

### Background

The conversion of a defined contribution (DC) provision of a pension plan to a defined benefit (DB) provision is an amendment to a continuing pension plan. In accordance with section 81 of the Act, an amendment may not reduce an individual's benefits with respect to service prior to the effective date of the amendment. Therefore, the primary concern in the conversion process is to ensure that the value of a member's accrued benefit, in this case a DC account balance, is preserved. There are two methods of achieving this end.

The first method is to amend the pension plan to be DB for future service only and maintain the DC provisions respecting DC accounts accrued to the date of the amendment.

The second method is to convert the pensionable service accrued under the DC provision to pensionable service under a DB provision. A comparison test is done at the date of conversion to ensure that the value of the DC benefit is preserved.

An actuarial valuation, cost certificate and commuted value basis relating to the defined benefits must be submitted with the plan amendment.

## Method One

This method simply requires the plan to be amended to cease providing future accruals on a DC basis and instead provide DB accruals for future service.

**NOTE: The plan sponsor may elect to make this change compulsory, or at the member's option.**

## Method Two

This method requires the conversion of service under the DC provision into credited service under the DB provision. However, a comparison test must be performed in order to ensure preservation of the accrued DC benefits at the time of conversion. The initial valuation must include a conversion valuation as follows:

### STEPS IN THE CONVERSION PROCESS:

For each member

- 1) Calculate the "past service" DB pension.
  - apply the DB formula to the member's years of service under the DC provision, to determine the possible DB benefit to be credited to the member as at the date of conversion
  
- 2) Calculate the Commuted Value (CV) of the DB pension determined in (1).
  - the CV is calculated by applying the *Canadian Institute of Actuaries Standard of Practice for Determining Pension Commuted Values*.
  - the CIA Standard of Practice may be adjusted by applying:
    - going-concern salary assumptions;
    - going-concern withdrawal assumptions; and
    - going-concern pre-retirement mortality assumptions

**NOTE: Any adjustments applied on conversion must be included in the benefit calculation done at termination, retirement or death, as it relates to the pre-conversion benefits**

- 3) Determine the DC account balance as at the date of conversion.
- 4) Compare the DC account balance determined in (3) to the CV determined in (2).
  - if the DC account balance is **greater than** the CV, the member is credited with the full DB past service and a DC account is maintained for the "excess" DC funds.
  - if the DC account balance is **less than** the CV, the plan sponsor may either:
    - a) credit the full DB past service to the member, and pay for the balance of the cost; or
    - b) pro-rate the past service so that the CV equals the DC Account Balance.

The plan sponsor must choose either option 4(a) or 4(b) above, and apply it equally to all members.

If option 4(a) is chosen, the plan sponsor can pay the additional cost either by an immediate lump sum, or by establishing an unfunded liability.

If option 4(b) is chosen, plan members must be given the option to refuse conversion and retain the DC account for service up to the date of conversion.

If the DB provision requires members to contribute to the plan, only the accrued contributions and DB pension relating to service from the date of amendment forward are required to be included when applying the 50% minimum employer cost rule at termination, retirement or death.

## Filing for Registration

### FILING REQUIREMENTS FOR BOTH METHODS

- 1) Plan amendment or revised plan text and any related board resolutions.
- 2) Any revised or new funding documents.
- 3) Actuarial valuation, cost certificate and commuted value basis.

NOTE: A separate CV basis may be required for service prior to the date of amendment versus service from the date of amendment onward relating to the defined benefits if the formulas are different before and after conversion date. If a conversion is occurring, a conversion valuation must also form part of the valuation report.

- 4) Written confirmation that the change in plan design, its implications, and the members' options have been fully disclosed to plan members. This should include copies of the information provided to members.
- 5) Revised employee booklet.
- 6) A list of plan members as at the date of amendment, including their:
  - a) names
  - b) accrued DC account balances

### AND ADDITIONALLY FOR METHOD TWO ONLY

- c) length of service under the DC provision
- d) commuted value of DB benefit based on full past service in c)
- e) amount that the DC account balance is in excess of the CV (or vice-versa)
- f) amount pro-rated DB benefit (if applicable)
- g) amount of pro-rated service relating to f) (if applicable)

The plan document must be amended to include relevant DB provisions. If any DC balances are to be retained, the plan document must maintain the appropriate provisions to allow for continued administration of the DC accounts.

Although not required, a separate funding document (trust or insurance contract) may be set up for the DB provisions (if both DC and DB provisions exist under the plan). Any such new documents, or any amendment to existing funding contracts, must be filed with the office of the Alberta Superintendent of Financial Institutions (ASFI).

As per section 20(1) of the Act and sections 27(2) & (4) of the Regulation, all filings must be made to the office of the ASFI **within 60 days after the amendment is made.**

The office of the Alberta Superintendent of Financial Institutions must review and approve any conversion before the plan sponsor may implement it.

*NOTE: Since this process is a plan amendment and not an opportunity for portability (which is available only at termination of membership, or termination of the plan), transfer of DC amounts out of the plan is not permitted.*

For further information please contact:

Alberta Superintendent of Financial Institutions  
Alberta Finance  
Room 402, 9515 - 107 Street  
Edmonton, AB T5K 2C3

Telephone: (780) 427-8322  
Fax: (780) 422-4283  
Internet: [www.finance.gov.ab.ca](http://www.finance.gov.ab.ca)

For toll-free dialling, contact your local Alberta Government R.I.T.E. line by calling 310-0000.