

Policy Bulletin #8

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Conversion of a Defined Benefit Plan to a Defined Contribution Plan

This Bulletin deals with the requirements for converting a defined benefit provision to a defined contribution provision. It is a revision of a previous bulletin. It has no legal authority. The Act and Regulation should be used to determine specific legislative requirements.

Conversion Constraints The conversion of a defined benefit provision to a defined contribution provision is considered an amendment to a continuing pension plan. In accordance with section 81 of the Act, an amendment may not reduce an individual's benefit entitlement with respect to service prior to the effective date of the amendment. Hence, the primary concern in the conversion process is to ensure that the value of an individual member's accrued benefit is preserved.

There are two methods of treating benefits accrued to date. The first is to preserve the accrued defined benefits to date of the amendment as a liability under the plan. The second method is to determine the commuted value of a member's accrued benefit and then to transfer that commuted value to the member's account under the revised defined contribution provision.

The first method requires a more complex plan document, as both types of benefits must be covered. Also, triennial actuarial valuations continue to be required as there is still a defined benefit provision in the plan and the employer continues to be liable for any unfunded liabilities or solvency deficiencies that may arise over time.

Under the second method, a conversion valuation is required at the time that the plan is amended. Further valuations are not required, as the plan, thereafter, becomes purely a defined contribution plan.

The employer may make the decision to convert past and/or future service or may make the choices optional for the members.

A plan may allow existing members to opt to remain in the defined benefit provision while making the plan defined contribution for new hires.

Documents to be Filed

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

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

Requirements

THE PLAN

The revised plan document must meet the requirements of the Act with respect to defined contribution provisions. If accrued defined benefits are being preserved, it must also meet all of the contractual requirements of the Act respecting defined benefit provisions. If defined benefits are being commuted, recognition of the crediting of member 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 pre-conversion benefits must be at least as favourable as that in effect prior to the amendment. Early retirement, survivor and/or death benefits must also be preserved.

THE FUNDING 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 Superintendent. Any changes in funding vehicles related to the revised defined contribution benefits must also be filed.

THE ACTUARIAL VALUATION

Contents of the Conversion Valuation

If the accrued defined benefits are being preserved, a full valuation is not required. However, an interim cost certificate and a list of all DB members affected by the amendment, as well as their accrued monthly benefit at the date of the plan amendment, is required. Triennial actuarial valuations and cost certificates will continue to be required.

If the defined benefits are being commuted, a full conversion valuation must be filed. The conversion valuation should include the following items:

1. The basis used to determine the value of the defined benefits. This basis may not result in any individual member's benefit being less than that which would be received if the Canadian Institute of Actuaries' Recommendations for the Computation of Minimum Transfer Values of Deferred Pensions were used.
2. The value of any special or ancillary benefits must be included in determining the value of any individual's 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 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 the required inclusion of a projection, the administrator or actuarial consultant should contact the Superintendent's office before proceeding with the valuation. Appropriate allowance may also be made for the probability of termination or death prior to retirement.
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.

Option to Purchase Annuities

The conversion of a defined benefit plan to a defined contribution plan transfers the risk previously assumed by the plan sponsor to the member. Because older members would have less time to recover from adverse market effects, where the plan is forcing everyone to convert, 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 sponsor may wish to extend this option to all plan members.

Treatment of Excess Assets

The treatment of excess assets (assets in excess of liabilities in a going-concern plan) will be determined largely by plan provisions. If the plan allows, the employer may apply for withdrawal of the excess. All Act requirements for an excess asset refund must, however, be met before any refund may occur. Please refer to the [Policy Bulletin #4 - Removal of Funds from Pension Plans](#), for details on proper procedures in this regard. Alternately, excess assets may remain in the fund to offset future employer contributions required by the defined contribution plan, or some or all of the excess 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 Superintendent. The allocation method may be included in the conversion valuation or may be done separately.

Insufficiency of Assets

Where a conversion valuation is done, and assets are insufficient to fund the accrued defined benefit liabilities, it is recommended that the employer make a lump sum payment to immediately fund the entire solvency deficiency. If this is not possible, the employer may arrange to fund the solvency deficiency over a period not exceeding five years. In this latter case, details of the funding arrangements must be confirmed with the Superintendent before any action is taken.

Treatment of Pensioners and Deferred Members

A defined benefit plan which has been paying pensions from the fund and/or holding the benefits of deferred vested members may either continue to hold the funds, 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 the employer wishes to discharge these liabilities, individual annuities must be purchased for pensioners. This may also be done for deferred vested members, though it may be preferable first to provide them with the option to transfer their benefits to a LIRA. Please note that a group annuity contract does not serve to remove these members from the plan unless the annuity contract specifically guarantees to insure all solvency deficiencies that could arise in future.

Excess Employee Contributions

Where accrued defined benefits are maintained and the pension plan is converted to a defined contribution for future service only, the amount of any excess employee contributions is not to be determined until:

1. the termination of membership or of the whole plan,
2. the commencement of the member's pension,
3. the member's death, or
4. any subsequent conversion of the defined benefit provision.

Member contributions to the defined contribution provisions are not to be included in this calculation.

Information to Employees

Where all benefits, whenever accrued, are converted to a defined contribution provision, the amount of any excess contributions is to be determined as of the time of the conversion and the excess contributions may be used in accordance with the options listed in section 37(2) of the Act.

As noted earlier, changing a pension plan from defined benefit to defined contribution transfers the risks of the pension plan from the plan sponsor to the plan member. Because of this it is imperative that members fully understand how the change affects them. A full 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 be particularly relevant if the option to purchase deferred annuities is not being given to all members.

Timing, Process, and Deadlines

Conversion of a defined benefit to a defined contribution provision is a plan amendment and as such, the amended plan text must be submitted within 60 days after the amendment or decision to amend is made. Where the amendment involves converting and transferring the accrued defined benefit to the defined contribution provision, the conversion normally may not proceed and statements may not be issued to members until all required documents have been filed and the Superintendent has consented to the conversion. Where it is not possible to file all documents before conversion is to occur, the Superintendent may, upon request, approve the alternative process set out below.

In order to consider approving the alternative process, the Superintendent must receive:

1. the plan sponsor's written request for the alternative process, describing the special circumstances justifying the alternative process; and
2. a written opinion from the actuary confirming that following the conversion the plan solvency ratio will be at least 1 and no solvency deficiency will be created.

THE ALTERNATIVE PROCESS

A. Preliminary acceptance of the conversion basis

In order to issue statements to members before filing the full conversion valuation the actuary may file

1. a description of the planned conversion (is it voluntary or compulsory, is the commuted value being enhanced compared with the normal Minimum Transfer Value, and any other relevant consideration); and
2. a detailed description of the conversion basis.

The Superintendent will review the statement and identify any potential issues to be dealt with before member statements are issued.

B. Conditional consent to convert and transfer funds

To receive conditional consent to the conversion and transfer of funds the actuary must file

1. a preliminary conversion report including a list of members and their conversion amounts as shown on the statements issued to them, and conservatively estimating the effect on the defined benefit plan, and
2. a draft plan amendment or restated plan text.

C. Final registration

If the Superintendent grants permission to transfer funds, the final conversion valuation report showing whose benefits were actually converted and the actual effect of the conversion, as well as the signed amendment or restated plan text must be filed within 30 days after the conversion date.

For further information please contact:

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