Guideline

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Purpose

This document replaces the document entitled “Guidelines for Converting Plans from Defined Benefit to Defined Contribution” that was issued by OSFI in April 1992. This document describes what OSFI normally considers before authorizing the conversion of accrued defined benefits to lump sums.

1. Introduction

This document replaces the document entitled “Guidelines for Converting Plans from Defined Benefit to Defined Contribution” that was issued by OSFI in April 1992.

OSFI must review proposed conversions of accrued defined benefits to lump sums to determine, in accordance with subsection 10.1(2) of the *Pension Benefits Standards Act, 1985* (PBSA), whether these lead to a reduction of accrued benefits. This guideline explains what OSFI normally considers in determining whether a conversion results in a reduction of accrued benefits. Employers must also consider the provisions of the plan text and trust agreement which may impose further obligations to plan members and/or beneficiaries or restrictions with respect to plan amendments.

Members whose benefits are targeted by the conversion must have the option of retaining their accrued benefit as a defined benefit.

2. Treatment of Benefits Accrued to Conversion Date

Plans may be amended to change the nature of benefits earned in the future, provided these amendments are in accordance with the provisions of the *Pension Benefits Standards Act, 1985* (PBSA), as well as the terms of the plan and supporting documents.

Two options are available to the plan administrator with respect to the treatment of benefits accrued prior or up to the conversion date:

1. Retain the accrued defined benefits (addressed in section 2.1 of this guideline).
2. Offer to each member the option to substitute a lump sum of equal value to the accrued benefit and transfer this lump sum to a defined contribution account (addressed in section 2.2 of this guideline).

The administrator may withhold from some categories of members, such as those within 10 years of retirement, the option to convert their accrued benefit.

2.1 Retained Accrued Defined Benefits

Two options are available to the administrator:

1. Maintain a pension fund for the defined benefit.
2. Purchase annuities to guarantee the accrued benefits (addressed in section 2.1.1 of this guideline).

2.1.1 Accrued Benefits Guaranteed Through Annuity Purchase

The annuities purchased must provide substantially the same benefits as were provided under the terms of the plan, including:

- death benefits (PBSA sections 22 and 23);

- minimum employer contributions (section 21) with any excess benefit determined as if the member had terminated at conversion; and
- any guaranteed indexation.

Where accrued benefits depend on a projection of salaries, the purchase of annuities for the accrued defined benefit is permitted if it is based upon projected member earnings.

Reasonable termination rates can be used in the projection of salaries, in recognition that not all members will reach normal retirement age. Because only an estimate is being insured, members must be allowed to choose between the annuity and the transfer of an equivalent lump sum to a defined contribution account.

2.2 Transfer of Lump Sums of Equal Value to Defined Contribution Accounts

Lump sum transfers resulting from a plan conversion are not available to members since membership has not terminated.

Again, members must be offered the choice of the lump sum or a continued defined benefit (possibly based on a projected salary).

3. Need for Valuation Reports To Be Filed After Conversion

If the plan maintains a defined benefit component, the plan administrator must continue to file regular actuarial valuation reports.

If annuities are purchased to provide for all defined benefits, or if all members choose to have their defined benefits converted to equivalent lump sum amounts, actuarial valuations are no longer required. The sponsor remains responsible for providing these annuities if the insurer is unable to do so.

Exception: Actuarial valuations are required if the administrator transfers lump sums to defined contribution accounts, and guarantees that the retirement benefit relating to service prior to conversion will not be less than the accrued benefit under the terms of the plan at that time.

4. Conversion of Defined Benefits

The lump sum calculation should recognize all benefits provided under the terms of the plan, including:

- death benefits (PBSA sections 22 and 23);
- minimum employer contributions (section 21) – lump sum equivalents should account for the value of any excess contributions;
- any guaranteed indexation; and
- any ancillary benefit, including, for those who do not already qualify, an assumption as to the probability of their ultimately qualifying for the benefit if the plan had remained unchanged. This is further addressed in section 6 of this guideline.

4.1 Minimum Value of Converted Benefits

The lump sum equivalent must at least equal the member's transfer value, based on the Canadian Institute of Actuaries' Recommendations for the Minimum Transfer Values of Pensions, and calculated as if the member had terminated at conversion.

4.2 Actuarial Basis

Lump sum equivalents to defined benefits offered for transfer to defined contribution accounts should be calculated using economic assumptions that are at least as favourable to the members as the economic assumptions specified in the CIA Transfer Value Recommendations.

The value of benefits tied to final average or best average earnings must be calculated with a projection of salaries, in accordance with the terms of the plan. Similar to the case where accrued benefits are guaranteed through annuity purchase, reasonable termination rates can be used in the projection of salaries, in recognition that not all members will reach normal retirement age.

The conversion basis should reflect the effect that inflation, merit and service would have had on accrued defined benefits. Although the CIA Transfer Value Recommendations do not directly provide for salary increase assumptions, they state that the Consumer Price Index plus 1% should be used as a proxy for indexation to the

average wage index. OSFI considers this recommendation when assessing conversions of benefits tied to salary projection.

The assumptions used to convert accrued benefits tied to salary projection are key to ensuring that removal of the plan's obligation with respect to accrued defined benefits is carried out in a manner that is fair to members. This is of particular importance when the sponsor has notified members that it does not intend to maintain a pension fund for defined benefits.

4.3 Recalculation of the Commuted Value

The issue of recalculation should be addressed in the conversion report.

Circumstances (delays in transferring conversion values, changes in economic conditions, information given to members on the respective values of their options, surplus allocated to converting members, etc.) will dictate whether conversion values should be recalculated.

4.4 Use of Sex Distinct Tables for Commutation

The PBSA allows the use of sex distinct annuity tables. However, they must not result in benefits that vary materially by sex: if accrued benefits are converted to a lump sum on a sex distinct basis, these sums (accumulated with interest) must, at retirement, be used to purchase annuities established on the same basis.

Therefore, if plan administrators convert accrued benefits into lump sum equivalents using sex distinct annuity factors, the resulting conversion values must not be commingled with accounts that are generated from contributions made on a unisex basis. Since most money purchase plans contribute on this basis, this requirement imposes a limitation on the use of sex distinct mortality for conversion purposes.

5. Benefits Subject to Consent

Plans converting from defined benefit to defined contribution remain going concerns. How benefits subject to the consent of the administrator are accounted for in the conversion values will depend on the plan administrator's policy and practice regarding consent benefits, as well as member understanding through collective agreements,

booklets and other communications.

For example, the fact that the administrator has consistently granted these benefits to all eligible members who apply suggests that the benefits should be included when determining conversion values. If a benefit subject to consent is excluded from the conversion values, the actuary should so indicate in the conversion report. This fact must also be communicated to members when they are informed of the proposed conversion.

6. Ancillary Benefits

The inclusion of bridge, subsidized early retirement, and other ancillary benefits in member conversion values is a function of related requirements stated in the plan text and its definition of pensionable age. Also, because lump sum equivalents can be no less than member transfer values, the administrator must account for the requirements of section 17 of the PBSA, which provides that a member (whose benefit is vested) is entitled upon termination to a "deferred pension benefit, based on employment and salary up to the time of termination…that, if the member had attained pensionable age, the member would have been eligible to receive."

Pensionable age is the earliest age at which an unreduced pension benefit is payable to a member under the terms of the pension plan without the consent of the administrator.

For example, the value of a bridge benefit payable upon attainment of pensionable age with 20 years of service must be included in members' lump sums if they have the required number of years on the date of conversion, just as it would have to be recognized in the transfer value if the member were to terminate on that date.

Additionally, where members whose benefits are converted are not yet entitled to an ancillary benefit, conversion values should account for the possibility that, had the plan remained unchanged, they might have subsequently qualified.

7. Conflict with Canada Customs and Revenue Agency (CCRA) Rules

CCRA rules regarding the deductibility of contributions or tax-free transfers do not override the PBSA. The PBSA (section 10.1) prohibits amendments that have the effect of reducing accrued benefits without the authorization of

the Superintendent. However, if the conversion value calculated by the actuary is larger than the maximum prescribed in the case of conversions of defined benefits to lump sums, the portion in excess of the maximum may be unlocked.

Again, the administrator may withhold from some categories of members the option to convert their accrued benefit.

8. The Funding of Employer Current Service Costs from Surplus

An employer may wish to use surplus that has developed in a defined benefit plan to provide future contributions or pay plan expenses in the converted plan. If the documents for the defined benefit plan permitted contribution holidays, and if the amended plan documents continue to permit them, the plan can generally use accumulated surplus for contributions after conversion.

9. Conversion of a Plan That Is Not Fully Funded

A plan that is not fully funded may be converted. The shortfall between assets and liabilities on the conversion date may be addressed in one of two ways:

1. For each converting member, the employer initiates a defined contribution account for the full value of the member's entitlement on the conversion date, making up the deficiency from corporate sources.
2. Transfers into the defined contribution accounts are limited to the value of the member's entitlement multiplied by the ratio of plan assets to solvency liabilities after conversion. Solvency liabilities associated with converted benefits must be equal to those members' post-conversion accounts. The employer sets up an amortization schedule to fund the deficit within five years, reporting special payments to OSFI as they are made.

If, following the conversion, there remain defined benefits in the plan, the solvency ratio of the defined benefit component of the plan must be at least equal to the plan's solvency ratio prior to conversion.

Post-conversion experience of the defined benefit component of the plan must not affect the defined contribution portion. The defined contribution portion of the plan must, through special payments, be fully funded no later than five years after the conversion date.

9.1 Initial Defined Contribution Accounts Less Than Full Value of Member Entitlements

Each defined contribution account must receive a pro-rata portion of the special payments as they are made. These must include interest equal to or greater than the interest rate assumption used in the report to determine conversion values.

The amount owing to converting members must be fully remitted no later than five years after the conversion date.

9.2 Individual Terminations, Retirements and Deaths Within Five Years of Conversion

Where initial defined contribution accounts are less than the full value of member entitlements, the conversion report must state how terminations, retirements and deaths within five years after the date of conversion will be handled:

- 1.(a) If the event entails a transfer to a LIF, locked-in RRSP or other registered pension plan (e.g., converted member terminates within five years and opts for a transfer), the employer may transfer the full defined contribution account (i.e., its value on the date of the event plus the amount owing), and pay the deficiency from corporate sources.
- 1.(b) If only the actual value of the defined contribution account on the date of the event is transferred, the remainder is due no later than five years after the conversion date.
- 2. If the event requires the purchase of an annuity (e.g., the survivor opts for an immediate pension), it must recognize the value of the defined contribution account on the date of the event, plus the amount of the deficiency, paid by the employer from corporate sources.

9.3 Plan Termination Within Five Years After the Conversion Date

Member benefits in the defined benefit component of the plan are adjusted in accordance with the defined benefit component's solvency status on the date of termination.

Member benefits in the defined contribution component of the plan will be the actual value of the defined contribution account on the date of termination.

10. Interest Credited Between Dates of Conversion and Transfer

Transfer to the defined contribution account typically occurs some time after conversion. The conversion report should state what rate of interest will be credited to conversion values in the period between determination and transfer out of the defined benefit fund.

Appendix – Filing Requirements and Communication to Members

1. Notice to OSFI

As for any amendment, OSFI must be notified of a **plan** conversion, from defined benefit to defined contribution.

Required documents, discussed in section 3 of this appendix, must be filed with OSFI and the administrator should receive OSFI's comments before implementing a **benefit** conversion scheme.

2. Notice to Members

Members and their spouses, if their rights are affected by the plan conversion, must be notified no more than six months after the effective date of a plan conversion. Earlier notice is necessary if members are being given a choice to convert their accrued benefits. It is also desirable for the employer to provide all affected members with revised employee booklets.

If the amendment permits changes to benefits accrued to date, members must be given statements providing detailed information about their individual benefits and the options they are being offered. These statements should clearly show that the member has a choice between retaining the accrued defined benefit based, where

appropriate, on a projection of salary, or transfer of a lump sum equivalent. They must also indicate the respective values of these options (e.g., by showing what benefit may be purchased under various scenarios).

Plan administrators may be reluctant to provide specific lump sums to members before receiving OSFI's comments concerning a benefit conversion. However, OSFI will not give its comments or recommend that a conversion be authorized without examining the information and options presented to the members. To avoid an impasse, the plan administrator can present options to members that are conditional on receiving OSFI's comments or the Superintendent's authorization of the benefit conversion. Otherwise, the administrator can provide specimen notices to obtain OSFI's comments before approaching the members and preparing the final conversion report.

If the conversion does not change benefits accrued to date, the employer need not issue statements to individual members concerning their accrued benefits as part of the plan conversion process. Section 23 of the Pension Benefits Standards Regulations, 1985 will continue to require the employer to issue individual annual statements with prescribed information.

3. Documents To Be Filed With OSFI

3.1 Documents To Be Filed Following a Plan Conversion

- plan amendments or restated plan text;
- any board resolutions related to the conversion; and
- any other document not already filed with OSFI that creates or supports the plan or the pension fund.

3.2 Other Documents To Be Filed No Later Than Six Months Following Conversion

- samples of the notice of the plan conversion and statement of benefits and options distributed to members;
- where defined benefits are being preserved, a statement detailing the change in costs with respect to those benefits; and
- a conversion report prepared by an actuary following the Standard of Practice for the Valuation of Pension Plans issued by the Canadian Institute of Actuaries. The contents depend on the employer's intentions and the plan's circumstances:

1. Where benefits accrued to the conversion are retained as defined benefits, to be paid from a plan fund:
    - the report must address changes in contribution rates; and
    - actuarial valuations are still required at intervals no greater than three years.
2. Where the form and amount of accrued benefits are unchanged and fully guaranteed through the purchase of annuities:
    - the report must certify that this has been done and must describe the treatment of surplus.
3. Where accrued benefits are converted but guaranteed to be no less, at retirement, than what members would have received under the defined benefit formula:
    - the report must address changes in contribution rates and show the plan's liability for both the defined benefits and for defined contribution accounts; and
    - actuarial valuations are still required at intervals no greater than three years (unless the conversion report satisfies OSFI that the guarantees are not significant) and must indicate the defined contribution and defined benefit liabilities.
4. Where accrued benefits are guaranteed through the purchase of annuities for amounts that depend on a projection of salaries, or substantially alter an ancillary, early or late retirement benefit:
    - the report must verify that members were offered an equivalent lump sum, describe the assumptions and methods that led to the conclusion that the annuities and lump sum equivalents offered are at least as valuable as the accrued benefits in their original form, and describe, where applicable, how salaries were projected.

Unless the form and amount of benefits accrued before the conversion are unchanged, the actuary should include in the conversion report, or provide in separate listings, information that OSFI can use to verify that the actuary has followed OSFI's policy and the requirements of the PBSA. Plans with more than 100 members may provide a sample statement instead of information for every member.

The information is to include:

- name or member identification number;
- sex and date of birth;

- current salary and projected salary, if the salary has been projected;
- date of hire;
- length of credited service;
- accrued pension arising from service before 1987;
- accrued pension arising from service after 1986;
- pension benefit credit, pre-1987;
- pension benefit credit, post-1986;
- member contributions with interest;
- excess contributions under section 21 of the PBSA; and
- assumed retirement date.