This material is required reading for purposes of the CEBS program and the national exams for the RPA 1 course administered on or after October 15, 2018.

This update covers Chapter 8 of the textbook—*Morneau Shepell Handbook of Canadian Pension and Benefit Plans, 16th Edition*—and Modules 1, 2, 3, 4, 5, 7, 9, 11 and 12 of the Study Guide (First printing: July 2017 and Second Printing: October 2017).
How to Use This Update

For the textbook and the printed version of the Study Guide:

Keep this update with your study materials. It should be read in conjunction with the assigned reading for RPA 1.

For the online Study Guide:

These updates will be reflected in the online versions of Study Guide Modules 1, 2, 3, 4, 5, 7, 9, 11 and 12.

Instructions

There are two types of updates:

1. Minor—Where changes are made to a small section of the text, changes are indicated in **bold**.
2. Major—Entire sections are provided as a replacement.
Chapter 8, Page 237, Post-Retirement Death Benefits: Add the following to the end of paragraph 1.

The surviving spouse will receive the pension until he or she dies, regardless of whether that is before or after the end of the 15-year guarantee period. Should the spouse die before the guarantee period expires, the estate will receive any remaining payments.
Page 15, Answer to Content Knowledge Review 6.2: Make changes to the last sentence of paragraph 2 indicated in bold.

Malik's annual pension would be $18,750 (1.5% \times $50,000 \times 25).

Page 17, Answer to Content Knowledge Review 6.8: Make changes to the first sentence of paragraph 1 indicated in bold and remove what is crossed out.

Because of cost sharing with employees, in a contributory DB pension plan, the level of employer contribution costs is lower, or alternatively, costs an employer less, or the employer may provide higher benefits than a noncontributory one with the same level of employer contribution. employer cost.

Page 23, Text Commentary: Insert the following commentary.

Employee Contributions, Text, Pages 82-83

Bullet 1 in the Table Advantage to Employer of a Contributory Plan: Make changes indicated in bold and remove what is crossed out:

- Cost sharing with employees (through the requirement for them to contribute) means that the level of employer contribution costs is lower, or alternatively, the costs an employer less, or the employer may provide higher benefits for the same level of contribution.
Page 7, Page reference for Content Knowledge Review 1.5: Make changes indicated in bold.

1.5 Provide a brief overview of the key characteristics of a deferred profit-sharing plan (DPSP). (Reading B, Deferred Profit-Sharing Plans, Study Guide Module 2, pp. 27-29)
Page 15, Page reference and Answer to Content Knowledge Review 5.5: Make changes indicated in bold.

5.5 Describe the ceiling on the amount of bridge benefits payable from a DB pension plan. (Reading A, Text Commentary, Study Guide Module 3, p. 21; Text, p. 240)

There is a ceiling on the amount of bridge benefits that may be paid from a DB pension plan. The maximum amount of periodic bridge benefit payments is the sum of Canada Pension Plan/Quebec Pension Plan (CPP/QPP) and Old Age Security (OAS) benefits the member would receive if he or she were aged 65 at the date the bridge benefit commenced. **There are two other limits to bridge benefits:**

1. If the member who qualifies for a bridge benefit is under the age of 60, the bridge benefit must be reduced by 0.25% per month between the date the bridge benefit commences and the date the member attains the age of 60, and

2. If the member who qualifies for a bridge benefit has completed less than 10 years of pensionable service, the bridge benefit must be prorated by the ratio of the member’s years of pensionable service to 10 years.

Page 19, Text Commentary: Insert the following commentary.

Pension Adjustments, Text, Page 227

Change the last sentence of paragraph 4 to:

In a DPSP, which has no employee contributions, the PA is equal to the employer contributions on behalf of the employee, **plus any forfeited amounts.**
Page 21, Text Commentary: Insert the following commentary.

Bridge Benefits, Text, Page 240

Make changes to paragraph 2 indicated in bold.

The maximum amount of periodic bridge benefit payments from a defined benefit RPP is the sum of the CPP/QPP and OAS benefits the member would be able to receive if he or she were age 65 at the date the bridge benefit commences. **There are two other limits to bridge benefits:**

1. If the member who qualifies for a bridge benefit is under the age of 60, the bridge benefit must be reduced by 0.25% per month between the date the bridge benefit commences and the date the member attains the age of 60, and

2. If the member who qualifies for a bridge benefit has completed less than 10 years of pensionable service, the bridge benefit must be prorated by the ratio of the member’s years of pensionable service to 10 years.
Page 2, Assigned Reading, Text: Make changes indicated in **bold**.

Text

Chapter 9, Pages 251 to 285 (to Funding Relief for Defined Benefit Plans)

Page 7, Answer to Content Knowledge Review 1.5: Remove what is **crossed-out** in section (a).

(a) Generally, all jurisdictions require that all full-time employees within the eligible class of employees be allowed to join a pension plan, but in Manitoba participation is **not** compulsory; “auto-enrollment,” where employees are automatically enrolled if they do not opt out within a specified time limit, is only allowed in Alberta and British Columbia.

Page 18, Text Commentary on “Registration Requirements and Applicable Laws,” Text, Page 254: Add to point 2 at the end of the page to reflect the introduction of administrative penalties.

In the event of noncompliance with the respective pension standards legislation, regulators in most jurisdictions can assess financial penalties and fines and, in some jurisdictions, can assess administrative penalties relating to delinquent filing of required reports.
Page 20, Text Commentary: Insert the following commentary.

Funding Requirements—Defined Benefit Plans, Ongoing and Solvency, Text, Pages 282-283

Change the last paragraph on page 283 to reflect changes to Ontario’s solvency funding framework to:

In 2018, Ontario changed its requirements for funding of DB plans. The new requirements incorporate stronger ongoing funding requirements and reduced solvency funding requirements.

Contributions, Text, Page 284

Add the following to the end of the paragraph to reflect changes to Ontario’s funding requirements for DB pension plans:

As of 2018, Ontario’s funding of DB plans added a requirement for funding of a provision for adverse deviations (PfAD), changed the requirements for funding of benefit improvements, and shortened the period over which unfunded liabilities can be amortized.

Contribution Holidays, Text, Pages 284-285

Add the following to the end of paragraph 2 on page 285 to reflect changes to Ontario’s funding requirements for DB pension plans:

As of 2018, Ontario’s funding of DB plans added a new requirement that restricts the ability of plan sponsors to take contribution holidays to occasions when the PfAD is fully funded, the contribution holiday does not reduce the plan’s transfer ratio below 1.05, actuarial certification is filed with the regulator, and plan members are provided with notice that a contribution holiday is being taken. Further, the maximum amount available for use as a contribution holiday is limited to 20% of the plan’s “available actuarial surplus.”
Page 20, Text Commentary on “Pension Governance Milestones in Canada,” Text, Pages 110-115, add the following columns at the end of the table, page 115:

<table>
<thead>
<tr>
<th>Date</th>
<th>Development</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>January 2016</td>
<td>Quebec eliminates solvency funding</td>
<td>Funding on a solvency basis no longer required.</td>
</tr>
<tr>
<td>January 2018</td>
<td>Ontario introduces administrative penalties</td>
<td>Superintendent of Financial Services given authority to impose administrative penalties for failure to comply with legislative requirements under PBA. An administrative penalty is a monetary penalty that is intended to promote compliance.</td>
</tr>
<tr>
<td>May 2018</td>
<td>Ontario introduces changes to DB pension plan funding regime</td>
<td>Added a requirement for funding of a provision for adverse deviations (PfAD), changed the requirements for funding of benefit improvements, and shortened the period over which unfunded liabilities can be amortized.</td>
</tr>
</tbody>
</table>

Page 58, Speaker Notes: Add the following consequence of poor plan governance to point 1 as a result of the introduction of administrative penalties in Ontario.

- Plan sponsors can be assessed an administrative penalty in the event of noncompliance with the PBA (including for late filing of required forms or reports).
Study Guide Module 7

Page 15, Page reference and Answer to Content Knowledge Review 4.6: Make changes to the page reference and to paragraph 2 indicated in bold.

4.6 Describe the accrued benefit and projected unit credit funding methods.
(Reading A, Text Commentary, Study Guide Module 7, p. 25)

Under the accrued benefit method and the projected unit credit method, the actuarial liability is the present value of the benefits (based upon the allocated portion of all projected final average earnings, if the plan is a final or best average earnings plan or an updated career average plan) expected to be paid for service accrued (or allocated) before the valuation date only. The difference between the actuarial value of the assets and the actuarial liability represents the funding excess (or unfunded liability).

The total current service cost (also known as the normal actuarial cost, or sometimes just normal cost) is the actuarial present value of the benefits that accrue (or are allocated) in respect of service in the first year after the valuation date.

The plan sponsor’s required contribution is this total current service cost reduced by the members’ required contributions (if any) plus any special payments required to amortize any unfunded actuarial liability.

Page 25, Text Commentary on “Accrued Benefit and Projected Unit Credit:” Make changes to paragraph 3 indicated in bold.

The total current service cost (also known as the normal actuarial cost, or sometimes just normal cost) is the actuarial present value of the benefits that accrue (or are allocated) in respect of service in the first year after the valuation date.
Page 2, Assigned Reading: Make changes indicated in **bold**.

Reading C
CAPSA Guideline No. 3, Guidelines for Capital Accumulation Plans (CAP Guidelines), Section 2.2, Investment Options, Study Guide Module 5, Pages **42-43**

Pages 7-21, Page references for Content Knowledge Review Questions. Several questions require page reference changes. Following is a summary of the questions affected: Make changes indicated in **bold**.

<table>
<thead>
<tr>
<th>Study Guide Page Number</th>
<th>Content Knowledge Review Number</th>
<th>Page Reference Changes</th>
</tr>
</thead>
<tbody>
<tr>
<td>7</td>
<td>1.3</td>
<td>(Text, pp. 198-199; Reading B, Guideline for the Development of Investment Policies and Procedures for Federally Regulated Pension Plans, Study Guide Module 9, p. <strong>39</strong> )</td>
</tr>
<tr>
<td>8</td>
<td>1.5</td>
<td>(Text, p. 199; Reading A, Text Commentary, Study Guide Module 9, p. <strong>25</strong> )</td>
</tr>
<tr>
<td>9</td>
<td>1.6</td>
<td>(Text, p. 198; Reading B, Guideline for the Development of Investment Policies and Procedures for Federally Regulated Pension Plans, Study Guide Module 9, p. <strong>38</strong> )</td>
</tr>
<tr>
<td>9</td>
<td>1.7</td>
<td>(Reading B, Guideline for the Development of Investment Policies and Procedures for Federally Regulated Pension Plans, Study Guide Module 9, p. <strong>49</strong> )</td>
</tr>
<tr>
<td>10</td>
<td>1.8</td>
<td>(Reading B, Guideline for the Development of Investment Policies and Procedures for Federally Regulated Pension Plans, Study Guide Module 9, p. <strong>51</strong> )</td>
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<tr>
<td>10</td>
<td>1.9</td>
<td>(Text, pp. 199-200; Reading A, Text Commentary, Study Guide Module 9, p. <strong>25</strong> )</td>
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<tr>
<td>17</td>
<td>4.1</td>
<td>(Reading A, Text Commentary, Study Guide Module 9, pp. <strong>26-28</strong> )</td>
</tr>
<tr>
<td>Study Guide Page Number</td>
<td>Content Knowledge Review Number</td>
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<tr>
<td>17</td>
<td>4.2</td>
<td>(Reading A, Text Commentary, Study Guide Module 9, p. 26)</td>
</tr>
<tr>
<td>18</td>
<td>4.3</td>
<td>(Reading A, Text Commentary, Study Guide Module 9, pp. 27-29)</td>
</tr>
<tr>
<td>18</td>
<td>4.4</td>
<td>(Reading A, Text Commentary, Study Guide Module 9, p. 29)</td>
</tr>
<tr>
<td>18</td>
<td>4.5</td>
<td>(Reading A, Text Commentary, Study Guide Module 9, p. 29)</td>
</tr>
<tr>
<td>19</td>
<td>4.6</td>
<td>(Reading A, Text Commentary, Study Guide Module 9, pp. 29-31)</td>
</tr>
</tbody>
</table>
Module 11 has been reprinted. Below is a summary of the changes.

Page 2, Assigned Reading: Make changes indicated in **bold**.

Reading A  
*Carswell's Pension Manager (CPM)* and *Text* Commentary, Study Guide Module 11, Pages 33-34

Page 25, Page Reference and Answer to Content Knowledge Review 5.8: Make changes indicated in **bold** and remove what is crossed out to reflect changes in the level of coverage provided by the Pension Benefits Guarantee Fund (PBGF).

5.8 Explain how the Ontario Pension Benefits Guarantee Fund (PBGF) protects pension plan members in Ontario. *(Text, pp. 461-462; Reading A, CPM and Text Commentary, Study Guide Module 11, p. 34)*  

Ontario is the only Canadian jurisdiction that maintains a guarantee fund in the event that a pension plan is terminated and there are insufficient assets to fund accrued benefits.

The PBGF was established in 1980 and is administered by the Superintendent of Financial Services. It is funded by a levy imposed on employers with pension plans whose members are subject to the PBGF guarantee.

Grossly simplified, the PBGF guarantees the first $1,500 per month in pension benefits that were earned in respect of employment in Ontario.

The PBGF applies fully to all pensioners and to all deferred or active members whose age plus service equals 60 and partially applies to those whose age plus service exceeds 50. Members whose age plus years of service is less than 50 receive no coverage. Certain benefits are not subject to the PBGF guarantee, including benefit improvements granted within the last five years and prospective indexation increases.
Page 31, Answer to Content Knowledge Review 7.3: Add the following sentence in bold to paragraph 2 to reflect changes in Ontario's DB funding requirements and the impact on the ability to improve benefits and/or take a contribution holiday.

**Some jurisdictions restrict the use of surplus for benefit improvements and/or contribution holidays, based on the plan's specific financial status.**

Page 31, Page reference to Content Knowledge Review 7.4: Make changes indicated in bold to reflect changes in Ontario's DB funding requirement and the impact on the ability to improve benefits and/or take a contribution holiday.

7.4 Indicate who may receive payments of surplus from a DB pension plan under ITA and the conditions under which such payments would be tax-exempt. *(Reading A, CPM and Text Commentary, Study Guide Module 11, p. 34; Reading D, Excerpts From CPM, Chapter 11, Pension Plan Surplus Section 11.7(b) and 11.7(c), Study Guide Module 11, pp. 75-76)*

Page 33, Reading A: Make changes to the title of Reading A and to paragraph 1 indicated in bold.

*Carswell's Pension Manager (CPM) and Text Commentary*

The CPM and Text Commentary expands upon or provides current and relevant applications to the required reading. It should be read in conjunction with the CPM and Text readings.

Page 34, *Carswell's Pension Manager (CPM) and Text Commentary*, insert the following commentary at the end of the page to reflect changes in Ontario's DB funding requirements and the impact on the ability to improve benefits and/or take a contribution holiday. This commentary also reflects changes to the level of coverage provided under the Pension Benefits Guarantee Fund (PBGF).

11.5(a) Legislation, Reading D, Study Guide Module 11, Pages 75-76

Note that a number of jurisdictions restrict the use of surplus for contribution holidays, including the regulations for DB plans implemented by Ontario in 2018. These regulations in Ontario also specify the circumstances under which surplus can be used to finance benefit improvements. Benefit improvements are prohibited if a plan is less than 85% funded on a solvency basis or less than 90% funded on a going-concern basis. Any benefit improvement must be fully funded on a going-concern basis within five years of its implementation.
As indicated in Module 4, Ontario’s funding requirements for DB plans added a requirement that restricts the ability of plan sponsors to take contribution holidays to occasions when the PfAD is fully funded, the contribution holiday does not reduce the plan’s transfer ratio below 1.05, actuarial certification is filed with the regulator, and plan members are provided with notice that a contribution holiday is being taken. Further, the maximum amount available for use as a contribution holiday is limited to 20% of the plan’s “available actuarial surplus.”

Pension Benefits Guarantee Fund, Text, Pages 461-462

Replace this section with the following commentary:

Ontario is the only Canadian jurisdiction that maintains a guarantee fund in the event that a pension plan is terminated and there are insufficient assets to fund accrued benefits.

The PBGF is administered by the Superintendent of Financial Services. It is funded by a levy imposed on employers with pension plans whose members are subject to the PBGF guarantee. The levy ranges from 0.75%-2.25% of a pension plan’s solvency deficiency.

Grossly simplified, the PBGF guarantees the first $1,500 per month in pension benefits that were earned in respect of employment in Ontario. As an example, if a plan is 60% funded, a member either receiving or entitled to receive a pension of $2,000 per month will receive $1,200 per month from the pension plan, but will receive an additional $600 per month from the PBGF to reflect the fact that he or she is receiving only 60% of the first $1,500 of his or her entitlement from the plan.

Certain benefits are not subject to the PBGF guarantee, including benefit improvements granted within the last five years, and prospective indexation increases.
Managing Special Situations—Corporate Reorganizations, Plan Terminations and Surplus

This module describes the impact of corporate reorganizations upon pension plans. Corporate reorganizations include a bankruptcy or insolvency situation, or the sale of all or part of an organization’s business, accomplished through the sale of either corporate assets or corporate shares. Employee rights, employer issues, the impact of union-negotiated plans and an identification of successor issues are all discussed. Since the result of reorganization can be the transfer of assets to a successor organization, asset transfers between plans are also discussed.

Two significant issues that commonly are considered through the reorganization process include:

1. The possibility of termination of the pension plan
2. Issues relating to the ownership of any pension plan surplus assets.

This module also covers matters relating to these two issues.

Pension plan termination (also called plan wind-up or discontinuance), refers to the cessation of benefit accruals and the disposition of assets and liabilities of a pension plan. Although a pension regulatory authority can order the termination of a pension plan, most commonly a plan is dissolved voluntarily by an employer. This module covers general intent of the contractual obligations, trust or fiduciary responsibilities and various statutes affecting plan terminations. For procedural details regarding application for termination, notice of termination and reporting requirements, refer to the pension standards legislation in the relevant jurisdiction.

It is possible that a pension plan has a surplus at a time of corporate reorganization or at the time the plan terminates. This module defines surplus and outlines how it can be dealt with given regulatory requirements.
Assigned Reading

Reading A
Carswell’s Pension Manager (CPM) and Text Commentary, Study Guide Module 11, Pages 33-35

Reading B
Excerpts From CPM, Chapter 12, Corporate Reorganizations, Study Guide Module 11, Pages 37-56

Text
Chapter 15

Reading C
Excerpts From CPM, Chapter 10, Pension Plan Terminations, Study Guide Module 11, Pages 57-66

Reading D
Excerpts From CPM, Chapter 11, Pension Plan Surplus, Study Guide Module 11, Pages 67-80

Candidate Note: The Carswell Pension Manual (CPM) readings make reference throughout to practices in each jurisdiction (e.g., Pension Benefits Standards Act (PBSA), British Columbia Pension Benefits Standards Act (BCPWSA), Ontario Pension Agency (OPA), etc.) as well as numerous court case decisions. This is generally not testable material.

Nontestable sections are noted with a line in the right margin of the page. Questions on the examination will test the overall intent of the pension standards legislation, general principles, common practices and significant differences among jurisdictions regarding ownership of plan surplus pension assets, and pension issues arising from corporate reorganizations.
Learning Outcomes

1. Describe different types of business reorganizations and the impact of each upon the various pension plan stakeholders.

2. Outline pension and other legislative standards considered when an organization sponsoring a pension plan undergoes a corporate reorganization.

3. Describe parties to a corporate sale structure purchase and sale agreement as they relate to pension plan obligations.

4. Describe different situations that may lead to a pension plan termination and the controls in place that determine the outcome of the termination.

5. Describe activities and concerns of the sponsor of a pension plan that terminates.

6. Describe the source of pension plan surplus monies and the different ways “surplus” can be defined.

7. Describe limitations placed upon sponsors of pension plans holding surplus monies.
Outline of Knowledge

A. Types of corporate reorganization
   1. Purchase of corporate shares
   2. Purchase of corporate assets
   3. Bankruptcy and insolvency
   4. Multi-employer pension plans (MEPPs)
   5. Master trusts

B. Employee rights at time of reorganization
   1. Type of corporate purchase
   2. Impact on contract of employment
   3. Vendor requirements of purchaser
   4. Rights to accrued pensions
   5. Vesting and eligibility rights at time of sale
   6. Impact of collective agreements

C. Employer issues
   1. Purchaser and vendor
   2. Intent of each party to sale
   3. Purchase and sale agreement
   4. Future of pension plan(s)
   5. Transfer/assumption of pension plan assets and liabilities
   6. Ongoing benefits

D. Regulatory oversight of asset transfers
   1. Prior approval
   2. Successor employer/successor plan requirements
E. Pension plan termination and wind-up

1. Definitions
2. Reasons for termination; who can declare
3. Plan documents authorizing wind-up rights and obligations
4. Regulatory oversight of process
5. Member rights at wind-up
6. Employer obligations at wind-up

F. Pension plan surplus

1. Definitions by type of plan and situation
2. Reason for surplus
3. Content of plan documents regarding surplus
4. Employer withdrawal of surplus
5. Income tax treatment of surplus withdrawals and transfers
Key Terms

- Purchase and sale agreement
- Vendor and purchaser
- Master trust
- Common law
- Contract of employment
- Closing date
- Material change
- Valuation assumptions
- Termination basis
- Ongoing plan basis
- Surplus
- Unfunded liability
- Contribution holiday
- Wraparound arrangement
- Group asset transfer
- Successor employer
- Successor plan
- Successor rights
- Plan termination
- Wind-up
- Replacement administrator
- Wind-up date
- Wind-up notice and wind-up report
- Grow-in rights
- Pension Benefits Guarantee Fund (PBGF)
- Bankrupt estate of employer
- Surplus definitions
- Surplus withdrawal
- Tax-exempt transfer
Content Knowledge Review

Learning Outcome

Describe different types of business reorganizations and the impact of each upon the various pension plans stakeholders.

1.1 Outline the three major factors that drive the changes to pension plan obligations at the time of a corporate sale. (Reading B, Excerpts From Carswell’s Pension Manual (CPM), Chapter 12, Corporate Reorganizations and the Pension Plan Section 12.4, Study Guide Module 11, pp. 42-43)

At the time of a corporate sale, the three major factors that will lead to changes to pension plan obligations are:

(1) The profile or nature of the sale (asset or share purchase) and type of pension arrangements sponsored by the parties to the sale

(2) The respective intentions of the parties to the sale, which would normally include intentions regarding the responsibility for pension benefits and control of the pension plan after the date of the sale; objectives regarding any asset transfers that may occur; and concerns around meeting the requirements of pension regulators and labour legislation

(3) The terms of the purchase and sale agreement.
1.2 Identify two types of corporate sale situations and the implications of each for various types of pension plans. (Reading A, CPM and Text Commentary, Study Guide Module 11, p. 33; Reading B, Excerpts From CPM, Chapter 12, Corporate Reorganizations Sections 12.2(a), 12.2(b), 12.2(c), 12.2(d), 12.3(b)(i)(A) and 12.4(a)(ii), Study Guide Module 11, pp. 37-39, 41 and 45-46)

A corporation may sell its shares, in which case the legal entity continues under the control of the new shareholders and any pension plans sponsored by the corporation will continue without any action required by vendor or purchaser (subject to the comments below relating to master trusts). Alternatively, a corporation may sell some or all of its assets and as a matter of corporate law the pension liabilities would remain with the vendor. As a result of this transaction, the vendor may decide to terminate the pension plan, retain the plan or transfer the plan (including the pension fund) to the purchaser.

Generally, under pension standards legislation, where a vendor that contributes to a pension plan sells, assigns or otherwise disposes of a portion of its business assets, a member of the pension plan who continues employment with the purchaser continues to be entitled to those benefits accrued under the vendor’s plan to the effective date of the sale.

In the purchase and sale agreement, the purchaser often agrees to assume the pension plan liabilities. In this situation, there are many possible implications for the vendor, purchaser and plan members. Generally these can be summarized as:

(a) The assignment of liabilities can be accompanied by an assignment of plan assets sufficient to meet the liabilities. Determination of the sufficient amount for a defined benefit (DB) pension plan depends upon the transaction itself and is normally the result of the negotiations around the transaction and regulatory requirements. For a defined contribution (DC) pension plan, the amount is determined very simply since plan liabilities are clearly defined as the value of member accounts at the date of the sale.

(b) If the plan is a classic multi-employer pension plan (MEPP) created under the terms of a collective bargaining agreement, the purchaser will step into the shoes of the vendor as a participant in the MEPP under successor rights provisions of labour relations legislation. The assumption of liability under these plans is generally not an issue, since the employer’s liability is usually limited to making the contributions required under the applicable labour agreement.

(c) If the vendor’s plan participated in a master trust along with plans of affiliated companies, such participation will necessarily cease upon the sale. Unless the purchaser is also participating in the master trust, the portion of the master trust held in respect of the vendor’s plan will be removed from the master trust. Note that this will apply in the case of a share sale as well, if the purchaser is not a participant in the master trust.
Learning Outcome

Outline pension and other legislative standards considered when an organization sponsoring a pension plan undergoes a corporate reorganization.

2.1 In the context of an asset sale, explain how common law views employees and what the vendor generally requires the purchaser to provide to employees in terms of the level of compensation and benefits. (Reading B, Excerpts From CPM, Chapter 12, Corporate Reorganizations Section 12.3(a), Study Guide Module 11, pp. 39-41)

A contract for employment is a contract for personal services and as such is not capable of assignment to the purchaser of assets under common law. A material change in any term of employment could result in employees claiming that their contract of employment has been unilaterally altered by the purchaser, possibly providing them with grounds for a wrongful dismissal action.

As a result, the vendor usually requires, as a term of the purchase and sale agreement, that the purchaser agree to provide employees with compensation and benefits substantially similar to those provided by the vendor. Where the vendor sponsors one or more pension plans, the purchaser is often required to maintain such benefits for a specified time period, for example, one year following the effective date of the sale, by either assuming sponsorship of the vendor’s plan(s), where appropriate; establishing a new plan; or ensuring the same level of benefits within a plan the purchaser already sponsors.

It should be noted that the purchaser is not forever tied to the benefits provided by the vendor.
2.2 Explain how pension plan members’ benefits and rights are treated when the assets of an organization are sold. (Reading B, Excerpts From CPM, Chapter 12, Corporate Reorganizations Sections 12.3(b)(i)(A) and 12.3(b)(i)(B), Study Guide Module 11, pp. 41-42)

Generally, when a vendor that contributes to a pension plan sells, assigns or otherwise disposes of all or a portion of its business or business assets, a pension plan member who continues employment with the purchaser continues to be entitled to accrued benefits under the vendor’s plan to the effective date of the sale. The employment of individuals who continue with the purchaser is deemed not to be terminated. Regardless of whether or not the purchaser assumes liability for the accrued pension benefits under the vendor’s plan, the service of an employee includes service with both the vendor and purchaser when determining (a) the vesting of benefits under either the vendor’s or purchaser’s pension plan and (b) eligibility for membership in the purchaser’s pension plan.

2.3 Explain the rationale for the requirement for prior approval from regulatory authorities, where parties to an asset sale transaction want to transfer assets from the vendor’s pension plan to the purchaser’s pension plan, and the focus of the regulator in their review of the requested transfer. (Reading B, Excerpts From CPM, Chapter 12, Corporate Reorganizations Sections 12.4(b)(iii) and 12.5(b), Study Guide Module 11, pp. 50-51 and 54)

Prior approval is required from regulatory authorities where parties to a transaction want to transfer assets from the vendor’s pension plan to the purchaser’s pension plan. Prior approval and consent allow regulatory authorities to ensure the protection of pension and other benefits to which the members and former members of the vendor’s plan are entitled.

Focus of the regulatory authorities includes whether a surplus or deficit exists in the pension plans, prescribed conditions for the inclusion of surplus in the transfer and any funding required if there is a deficit in the plan. Documentation authorizing the transfer out of the vendor’s pension plan, acceptance of the pension liabilities by the purchaser’s plan and actuarial certification of the amounts of assets involved will typically be required to be filed with the regulator.
2.4 **Explain the difference between successor employer and successor plan provisions included in pension standards legislation of many jurisdictions.** (Reading B, Excerpts From *CPM*, Chapter 12, Corporate Reorganizations Sections 12.5(b)(i)(A) and 12.5(b)(i)(B), Study Guide Module 11, pp. 53-55)

The successor employer provision protects plan members when an employer sells, assigns or disposes of all or a part of its business and as a consequence plan members become employees of the purchaser. It typically provides that, regardless of whether there is a transfer of assets representing the employees’ accrued pension benefits, service with both the vendor and purchaser must be recognized for eligibility and vesting purposes under both the vendor’s and purchaser’s pension plans.

The successor plan provision typically provides that when an employer stops contributing to the original pension plan and replaces the original plan with a new or existing pension plan, the replacement plan is deemed to be a continuation of the original plan. The successor plan provision applies in situations such as the merger of two or more pension plans, the division of a plan into two or more plans or the transfer of assets and liabilities out of the original plan into a newly registered pension plan (RPP).

2.5 **Identify the legislation that applies when the purchase and sale of all or part of a business involves unionized employees who are members of a pension plan.**

(Reading B, Excerpts From *CPM*, Chapter 12, Corporate Reorganizations Section 12.6(a), Study Guide Module 11, p. 56)

When the purchase and sale of all or part of a business involves unionized employees who are members of a pension plan, provincial and federal labour relations legislation dictates the rights and obligations of the vendor and purchaser.
Learning Outcome

Describe parties to a corporate sale structure purchase and sale agreement as they relate to pension plan obligations.

3.1 Explain how the purchase and sale agreement, in the context of an asset sale, will generally be structured to reflect factors that relate to DB pension plan obligations.

(Reading B, Excerpts From CPM, Chapter 12, Corporate Reorganizations, Sections 12.4(a)(i), 12.4(a)(ii), 12.4(a)(iii) and 12.4(a)(iv), Study Guide Module 11, pp. 45-48)

The purchase and sale agreement will generally be structured to reflect these matters relating to pension plan obligations:

(a) The future of the plan, including obligations of each party with regard to the pension benefits and plans that may be in place

(b) The valuation assumptions to be used in the determination of any asset transfer between the vendor's pension plan and the purchaser's pension plan. These assumptions can be based on either a continuing (ongoing) or terminating basis, and each basis results in different asset values. Accordingly, it is to the advantage of both parties to agree upon the actuarial valuation assumptions to be used and to document them in the purchase and sale agreement.

(c) The impact of the pension plan transaction upon corporate pension expenses and balance sheets, in accordance with accounting standards. These may vary between the parties to the sale and may influence negotiations around the purchase price.

(d) The existence of any pension plan surplus or unfunded liabilities. Regulatory issues may impact the availability of surplus monies to be withdrawn or used for contribution holidays, and unfunded liabilities may impact the purchaser's approach to adopting the plan.
3.2 Describe why the valuation assumptions used when determining DB pension plan liabilities should be agreed upon by both parties to an asset sale, and identify the two bases for the assumptions that are normally considered in this process.

(Reading A, CPM and Text Commentary, Study Guide Module 11, p. 33; Reading B, Excerpts From CPM, Chapter 12, Corporate Reorganizations Section 12.4(a)(ii), Study Guide Module 11, p. 46)

When determining the value of the assets of a pension plan, or the liabilities and associated assets to be transferred from the vendor’s to the purchaser’s plan, the valuation assumptions used in the calculations should be agreed upon by both parties. Otherwise, large discrepancies in the values determined by each side can occur. The acceptability of the assumptions to the pension authorities should also be assessed and may lead to some modification of the initial assumptions.

Basically, valuations can be conducted on a continuing (or ongoing) basis or on a terminating plan basis.

Given the low interest rate environment prevailing from late 2008 to today, the terminating plan basis currently would likely generate a higher plan liability than would the ongoing basis—and certainly would for a career average plan.
3.3 In the context of an asset sale and a DB pension plan, describe the options available to the purchaser with respect to recognition of employees’ service periods, how those options affect plan members and the impact upon the vendor and purchaser of the wrap around option. (Reading B, Excerpts From CPM, Chapter 12, Corporate Reorganizations Section 12.4(c)(i), Study Guide Module 11, pp. 51-52)

The purchaser’s plan may recognize all service with the vendor and the purchaser, or it may recognize only future service from the date the transaction closes. Implications of these alternatives include:

(a) If the purchaser’s plan recognizes all service (pre- and posttransaction), there is no break in benefit accrual and, to the extent that the terms of the purchaser’s plan duplicate those of the vendor’s plan, an employee's total pension from both plans will be the same as what would have been received had the member stayed in the vendor's plan until retirement.

For the vendor:

- This wrap-around arrangement protects the vendor from potential legal actions for breach of employment contracts.
- The vendor retains responsibility for funding pension benefits earned to the date of the transaction.
- As long as no assets transfer from the vendor’s plan to the purchaser’s plan, the vendor will not jeopardize the solvency status of its plan.

For the purchaser, the financial impact will depend upon the nature of the plan's benefit structure:

- In the case of career average or flat benefit plans, normally no unfunded liability will be created within the purchaser’s plan, since the portion of the benefit under the vendor’s plan will be funded by that plan and the purchaser will basically be funding future benefit accruals only.
- In the case of a final average earnings plan, future wage and salary increases will increase the value of the prior years’ benefits, typically the responsibility of the purchaser’s plan.

(b) If the purchaser’s plan only recognizes service from the date of the transaction, the employee will receive a pension from the vendor’s plan for service up to that date and a pension from the vendor’s plan for service after that date. If the vendor’s plan used a final average earnings formula, it is typical for that formula to be based on the period up to the date of sale rather than up to the individual's retirement. If the vendor’s plan was either career average or flat benefit with regular upgrades, the member may not benefit from upgrades that occur after the transaction. The member’s total pension will also depend upon the terms of the purchaser's pension plan.
3.4 In the context of an asset sale, when the vendor sponsors a DC pension plan, describe the impact on member pension benefits when the purchaser agrees only to recognize service from the date of the sale (i.e., future service only) within its pension plan. (Reading A, CPM and Text Commentary, Study Guide Module 11, p. 33; Reading B, Excerpts From CPM, Chapter 12, Corporate Reorganizations Section 12.4(c)(ii)(D), Study Guide Module 11, p. 53)

If the vendor’s plan is a DC pension plan, recognition of future service only by the purchaser does not have any effect on the employee’s total pension benefits, as long as the contributions made to the purchaser’s plan are at the same level as they were in the vendor’s plan.
Learning Outcome

Describe different situations that may lead to a pension plan termination and the controls in place that determine the outcome of the termination.

4.1 Indicate who may initiate the termination of a pension plan, differentiate between the terms “termination” and “wind-up,” and explain the meaning of a partial plan wind-up. (Text, pp. 444-446)

A pension plan may be wound up voluntarily by an employer, or in some circumstances the plan administrator, or by order of the regulator under whose jurisdiction the plan is registered.

The terms “termination” and “wind-up” are often used interchangeably. However, their technical meaning under the pension legislation in various jurisdictions can be quite distinct.

In some jurisdictions, a pension plan can be partially terminated. The partial termination of a pension plan involves the settlement of the pension benefits of a specific group of plan members.

Partial pension plan terminations are normally the result of the sale or discontinuance of a part of the employer’s business operations or of a significant reduction in plan membership resulting from employee terminations and layoffs.

Quebec, Prince Edward Island, Ontario, Alberta and British Columbia do not permit partial plan terminations, and the federal pension legislation does not allow an employer to declare a partial plan termination.
4.2 Outline the various reasons that a pension plan may be terminated. (Text, pp. 445-446)

Some circumstances that might cause a sponsoring employer to terminate its pension plan include:

(a) The sponsoring employer is party to a purchase or sale of a business, and the purchaser does not provide a pension plan or refuses to take on the existing pension obligation.

(b) The sponsoring employer has undertaken an internal reorganization under which the pension plan is no longer a priority.

(c) The plan has a significant surplus that the plan sponsor is looking to distribute.

Some circumstances that might cause a Canadian pension regulator to order the wind-up of a pension plan include:

(a) Employer contributions have ceased or been suspended (all jurisdictions).

(b) All or part of the business of the sponsoring employer has been discontinued (all jurisdictions).

(c) The plan has failed to meet prescribed solvency tests (some jurisdictions only).

(d) The sponsoring employer has declared bankruptcy (some jurisdictions only).

(e) The plan fails to comply with pension legislation (some jurisdictions only).

(f) The business has been sold to an employer that does not provide a pension plan for the affected employees (most jurisdictions).

4.3 Identify the aspects of a pension plan wind-up that are subject to Canadian pension standards legislation. (Text, pp. 448-455)

Canadian pension standards legislation contains requirements regarding these of pension plan wind-up and termination:

(a) Appointment of a replacement administrator

(b) Definition of wind-up date and, if required, wind-up period

(c) Timing, content and recipients of a wind-up notice and wind-up statement

(d) Content, preparer and timing of filing of wind-up report

(e) Application of special benefit provisions at wind-up

(f) Timing and method of asset distribution at wind-up

(g) Treatment of surplus/funding deficiencies at wind-up.
4.4 Outline the parties that may be charged with executing the wind-up process. (Text, pp. 447-449)

The entity or person charged with executing the wind-up process is typically the plan administrator.

In some circumstances, the employer is either unwilling or incapable of completing the wind-up that has been ordered by the regulator (the Superintendent). Pension legislation in all jurisdictions provides that the superintendent may either act as the replacement administrator or (more commonly) appoint a replacement administrator. In most jurisdictions, the appointment of a replacement administrator may only be made in circumstances where the pension plan is to be wound up.

There may be circumstances where the employer as administrator of an ongoing plan finds itself in a conflict of interest, suggesting that in such circumstances an independent replacement administrator may be appropriate.

Replacement administrators are typically appointed in circumstances where the employer is either bankrupt under the Bankruptcy and Insolvency Act or has obtained protection from its creditors under the Companies’ Creditors Arrangement Act, and it appears unlikely that the pension plan will be maintained.

4.5 Describe the rights and restrictions that apply to an employer wishing to terminate a pension plan that it sponsors. (Text, p. 445)

Pension legislation in all jurisdictions generally permits an employer to declare the wind-up of a pension plan. Legislation does not require that specific grounds or reasons exist for such a declaration to be made. This unrestricted discretion is subject to any obligations under a collective agreement governing the pension plan or any contractual obligation stemming from a corporate transaction in which the continuation of the pension plan for a certain period of time is a requirement.

In addition, the documents that create and support the pension plan, such as the plan text, must specifically provide that the plan sponsor, usually through the board of directors, has the right to terminate the plan.
4.6 **Explain the primary source of information regarding rights and obligations contained in a pension plan on plan termination.** (Reading C, Excerpts From *CPM*, Chapter 10, Pension Plan Terminations Section 10.3(a), Study Guide Module 11, pp. 57-58)

The documents under which the plan is set up are the primary sources for determining respective rights and obligations of a person who has an interest in or responsibility for the pension plan. Whenever a plan termination is contemplated, anyone who has an interest in the plan—sponsoring employer, a plan administrator, the funding agent, a regulatory agency, an employee or other beneficiary—should examine the terms of the plan documents that might affect the wind-up. These documents include the pension plan text and amendments, funding agreement, any collective agreements, arbitration awards or decrees, employee booklets, statements and other plan member communications—anything that establishes the terms and conditions of the pension promise.
Learning Outcome

Describe activities and concerns of the sponsor of a pension plan that terminates.

5.1 Describe the information and special benefit entitlements that members of a pension plan are entitled to receive when the plan is winding up. (Text, pp. 454-457)

As a general rule, all Canadian jurisdictions require that each employee entitled to a pension, deferred pension, refund of contributions or other benefit receive a statement that contains the same information as required in a retirement or termination statement, as applicable, under the applicable pension legislation. This information would include the employee’s entitlement under the plan and the options available to the employee.

When a partial or full-plan wind-up occurs, affected plan members gain special rights by virtue of the applicable pension legislation. In most jurisdictions these include:

(a) Full vesting of pension benefits accrued up to the wind-up date, regardless of the provisions specified by the pension plan

(b) Portability rights for all members other than pensioners, similar to those provided to members who terminate employment from an ongoing plan

(c) Application of the 50% rule, which provides for the employer to pay for at least 50% of the member’s entitlement from the pension plan

(d) In Nova Scotia and Ontario, grow-in rights for members whose age plus year of employment equal 55 or more. Grow-in rights give affected members the ability to receive pensions from the plan as if the plan had not wound up and membership had continued until such time as the member would have qualified for an unreduced or enhanced early retirement pension or a bridge benefit.

In most jurisdictions, it is also necessary to include on the statement information about the reduction of benefits due to a funding deficiency or disposition of surplus, if applicable.
5.2 **Identify the parties who must receive notice of a pension plan wind-up and who determine the content of the notice and the general content requirements for the wind-up notice.** (Text, pp. 450-452)

All jurisdictions require that written notice of the wind-up, full or partial, must be given by employers or plan administrators to a number of parties including, as the jurisdiction requires, members, former members, unions that represent members, other plan beneficiaries or any other person entitled to payment from the plan, plan advisory committees, if any, and the appropriate regulator.

The notice must be provided regardless of whether the wind-up is initiated by the employer or administrator or by order of the regulator.

A number of jurisdictions require that the wind-up notice include:

(a) The name of the plan and its registration number

(b) The proposed wind-up date

(c) A statement that each member, former member or any other person entitled to a pension, deferred pension, any other benefit or a refund will be provided with an individual statement setting out entitlements and options under the pension plan

(d) If the plan is contributory, a notice of the member’s right to make contributions in respect of the period of notice of termination of employment under employment standards legislation.

Some jurisdictions require more or less information than that described above.
5.3 Describe in general terms the requirements of pension standards legislation regarding the preparation and filing of a wind-up report for a pension plan.

(Text, pp. 453-454)

The general requirements for wind-up reports are:

(a) All jurisdictions require the preparation and filing of a wind-up report for a pension plan.

(b) The plan administrator is required to file a wind-up report, typically prepared by an actuary, with the appropriate regulator. If the pension plan is a DC pension plan, or a fully insured plan, most jurisdictions allow certain designated individuals to prepare the wind-up report.

(c) Filing deadlines for wind-up reports range from 60 days to six months from the date of termination of the plan.

(d) A wind-up report must reflect the terms of the pension plan as well as the pension legislation that governs the plan.

(e) Pension legislation specifically identifies what must be included in the report. Generally, all jurisdictions require that a wind-up report indicate the nature of the benefits to be provided to members, former members and other persons; the assets and liabilities of the plan; the method(s) for allocation and distribution of plan assets; and the priorities for determining payment of benefits.

(f) Depending on the jurisdiction, additional information may be required as prescribed in regulations or as mandated by the regulator, and each regulator may require additional information as stipulated in their respective policies and guidelines.

(g) If a wind-up report for a DB plan discloses a surplus, the administrator is required to indicate how the surplus will be dealt with. If this is not provided, a regulator may require a supplemental report dealing specifically with the surplus assets.
5.4 Describe the powers held by the pension regulator once the wind-up report has been filed and how objections to the regulator's decisions are dealt with. (Text, pp. 454 and 457)

A regulator must approve a wind-up report before any distribution of plan assets can occur. That being said, regulators will generally permit pensions or any other benefits that were in pay before the notice of proposal to wind up the pension plan to continue to be paid, pending the approval of the wind-up report. Despite this restriction, regulators do have the discretion to approve a payment prior to the approval of the wind-up report.

Delaying the distribution of plan assets until approval of the wind-up report is especially important when the pension plan that is being terminated or wound up has insufficient assets to fully cover all plan benefits.

A regulator has the authority to refuse to approve a wind-up report that fails to comply with the pension legislation that governs the plan. A regulator also has the power to require that a new report be prepared.

Generally speaking, should a regulator refuse to approve a wind-up report or approve a report over the objections of employees, the administrator, employees or any other affected party may have the decision of the regulator reviewed by a tribunal or other adjudicative body as the respective pension legislation permits.

5.5 Explain how surplus assets existing at the time of a pension plan termination may be distributed. (Text, p. 458)

The full termination of a pension plan that is in a surplus position will require the assessment of surplus rights in order for the assets to be fully distributed. It is always possible for the employer to pay the surplus to members, either as benefit improvements subject to maximums under the Income Tax Act (ITA) or as cash payments, provided that the plan contains provisions, or is amended to provide those provisions, that specify how this will be done.

If the employer wishes to withdraw the surplus, the consent of the regulatory authority is required. Generally, this consent cannot be given unless the employer is entitled to withdraw the surplus according to the plan terms, but some jurisdictions permit the employer and the members in the plan to reach an agreement as to how the surplus will be distributed, despite the plan provisions.
5.6 Identify challenges faced when pension plans with members in more than one jurisdiction wind up and what regulatory agencies are doing to minimize these challenges. (Text, pp. 458-460)

Challenges exist because rights available to employees typically vary by jurisdiction. For example, grow-in rights apply only in Ontario and Nova Scotia, but a plan may have members in other provinces as well.

Since 1968, the Memorandum of Reciprocal Agreement (“Memorandum”) has been followed by the Canadian pension regulatory authorities. The Memorandum provides for registration of a pension plan in the jurisdiction containing the plurality of active members. Member benefit entitlements are determined according to the member’s jurisdiction of employment, but there is no uniformity among jurisdictions on how to treat entitlements for employees who work in more than one jurisdiction. The two options being used are a final location approach and a checkerboard approach.

In 2008 a new agreement, the Agreement Respecting Multi-Jurisdictional Pension Plans (MJPP Agreement), was issued by the Canadian Association of Pension Supervisory Authorities (CAPSA). If adopted by a particular jurisdiction, this agreement replaced the Memorandum. The MJPP Agreement adopted the final location approach for the determination of benefits and included rules for the allocation of assets among jurisdictions in the event of a plan wind-up. A number, but not all Canadian jurisdictions adopted the MJPP Agreement.

In 2016 CAPSA announced that a new agreement (the “2016 MJPP Agreement”) had been adopted by the same jurisdictions that adopted the MJPP Agreement. CAPSA identified that the 2016 MJPP Agreement was negotiated as an interim measure while Canadian pension jurisdictions consider their solvency funding regimes.

The original Memorandum from 1968 remains in effect for those jurisdictions that have not signed the 2016 MJPP Agreement.
5.7 **Describe the liability for funding a pension plan generally assumed when a pension plan is wound up.** (Text, p. 460; Reading C, Excerpts From *CPM*, Chapter 10, Pension Plan Terminations Section 10.7(b), Study Guide Module 11, p. 65)

All jurisdictions require that upon termination of a pension plan the employer pay into the fund all amounts necessary to comply with the solvency rules up to that date. Some jurisdictions also require the payment of amounts that have accrued to the termination date but are not due to be paid by that date.

All jurisdictions in Canada, except Saskatchewan, now require the employer, in circumstances where a pension plan is wound up and there are insufficient funds to fully provide all member benefits, to fund any deficiency over a period of no more than five years. Saskatchewan requires that the employer fund all payments required under its pension legislation or the plan that have accrued to the date of wind-up (whether or not due), including all amounts that are due from the employer but not yet paid, like most of the other jurisdictions. However, only if the plan terminates during the temporary three-year solvency relief period, and if there is a solvency deficiency identified in the termination report, the employer will be required to pay the solvency deficiency in a lump sum or for a period not more than five years from the review date. There are some circumstances in which this requirement does not apply.

5.8 **Explain how the Ontario Pension Benefits Guarantee Fund (PBGF) protects pension plan members in Ontario.** (Text, pp. 461-462; Reading A, *CPM* and Text Commentary, Study Guide Module 11, p. 34)

Ontario is the only Canadian jurisdiction that maintains a guarantee fund in the event that a pension plan is terminated and there are insufficient assets to fund accrued benefits.

The PBGF is administered by the Superintendent of Financial Services. It is funded by a levy imposed on employers with pension plans whose members are subject to the PBGF guarantee.

Grossly simplified, the PBGF guarantees the first $1,500 per month in pension benefits that were earned in respect of employment in Ontario.

Certain benefits are not subject to the PBGF guarantee, including benefit improvements granted within the last five years and prospective indexation increases.
5.9 **Explain how the Bankruptcy and Insolvency Act affects pensions payable should an underfunded pension plan of an insolvent employer be terminated.** (Text, pp. 462-463; Reading C, Excerpts From *CPM*, Chapter 10, Pension Plan Terminations Section 10.3(a)(v), Study Guide Module 11, p. 63)

The appointed administrator of an underfunded pension plan that is being wound up has a claim against the estate of a bankrupt or insolvency employer for an amount needed to fully fund pension benefits.

The Bankruptcy and Insolvency Act provides a priority claim (i.e., a claim that ranks ahead of the estate’s unsecured creditors) for unremitted member contributions, as well as for unremitted current service cost payments that were past due as of the date of insolvency. Unremitted special payments and any future payments required are not granted priority status.

A number of jurisdictions provide that any pension contributions collected by employers from employees but not yet remitted to the pension plan are deemed to be held in trust for the pension plan. Manitoba also makes corporate directors of an employer personally liable for unremitted member contributions. Alberta and Manitoba specify that employer pension contributions that are due but not yet paid are also deemed to be held in trust.

Some jurisdictions (e.g., Ontario and Manitoba) provide the administrator of a pension plan with a lien over the assets of the employer for any amount of money equal to employer contributions accrued to the date of the wind-up but not yet due under the plan or regulations and deem any such funds owing to be held in trust for the pension plan. In Manitoba, the superintendent also has a lien against the personal property of corporate directors where there are unremitted employee contributions. Ontario’s Pension Benefits Act further provides that the superintendent has a lien over the assets of the employer equal to any amounts paid into the pension plan out of the PBGF.

The status of these statutory liens and deemed trusts in the context of employer insolvency has been frequently litigated, and in many cases the lien or deemed trust has been held to have no priority over other claims against the state of the bankrupt employer.

A general principle of bankruptcy law is that an owner may not qualify his or her interest in property by a provision that it will pass to a third party in the event of bankruptcy. A term in a pension plan that provides for a reversion of surplus assets to the sponsoring employer upon termination of the plan except in the event of the bankruptcy of the sponsoring employer, in which case plan assets are paid to employee beneficiaries of the plan, will not be binding on the trustee in bankruptcy to the extent that the surplus is attributable to the contributions of the bankrupt employer.
Learning Outcome

Describe the source of pension plan surplus monies and the different ways “surplus” can be defined.

6.1 Explain how surplus is identified under a DC pension plan and the options available for its use. (Reading D, Excerpts From CPM, Chapter 11, Pension Plan Surplus Section 11.2(a), Study Guide Module 11, pp. 67-68)

Under a DC pension plan, surplus is relatively easy to identify and is usually not significant. Surplus in a DC pension plan is typically that portion of plan assets attributable to employer contributions and the related investment earnings that have been forfeited by terminated plan participants who fail to meet vesting conditions under the terms of the plan.

ITA requires that each forfeited amount and all related investment earnings be either paid to the employer, reallocated to plan members or used to pay administrative, investment or similar expenses incurred in connection with a DC pension plan.

Each forfeited amount and all related investment earnings must be used on or before December 31 of the year immediately following the calendar year in which the amount was forfeited.
6.2 **Describe how “surplus” is defined in a DB pension plan and why it might exist.**

(Reading D, Excerpts From CPM, Chapter 11, Pension Plan Surplus Sections 11.2(b), 11.2(c) and 11.2(d), Study Guide Module 11, pp. 68-70)

“Surplus” in a DB plan is the excess of the actuarial value of the plan assets over the actuarial liabilities for the accrued benefits.

An ongoing DB pension plan is fully funded when a going concern actuarial valuation discloses that the actuarial value of the assets exceeds the actuarial liability for the accrued benefits. To the extent that the assets exceed the liabilities at the date of a valuation, the pension plan is in a surplus position at that date. The going concern surplus at any particular time is an estimated amount. The estimate of going concern surplus can vary substantially, depending on the actuarial asset valuation method that is used and the actuarial assumptions and methods that are used to determine the actuarial liability for accrued benefits. The going concern surplus in a pension plan is not a well-defined amount unless the related methods and assumptions are exactly specified.

When a plan is terminated, the surplus consists of that portion of assets not needed to discharge all the obligations for benefits accrued to the termination date according to the plan document, plus any additional benefits that may be required by statute. Benefits become payable, and are calculated from facts in existence, as of the effective date of the termination.

The assumptions made about future events rarely, if ever, match perfectly with actual experience. Therefore, when a financial assessment, or “valuation,” of a pension plan is made at a given time, the plan will be in either a surplus or a deficit position. When plan assets are greater than the actuarial liability for the accrued benefits to be provided by the plan, the plan has a surplus.
6.3 Explain why the accrued liability on a final average DB pension plan termination basis can be lower than on a going concern basis. (Reading A, CPM and Text Commentary, Study Guide Module 11, p. 33; Reading D, Excerpts From CPM, Chapter 11, Pension Plan Surplus Section 11.2(c), Study Guide Module 11, p. 69)

The accrued liability on a final average DB pension plan termination basis is usually lower than on a going concern basis. In a final average earnings plan, projected salary increases are no longer taken into account. Another source of difference among these valuations is that, for a plan termination valuation, the assets are typically assessed at market value. For a going concern valuation, different actuarial estimates of the value of assets may be used. In many situations, the surplus generated on plan termination is greater than that estimated for an ongoing plan. However, in some situations, the additional liabilities that may be imposed by statute as a result of the termination can cause the plan termination surplus to be less than the going concern surplus.

Given the low-interest-rate environment prevailing from late 2008 to today, the terminating plan basis currently would likely generate a higher plan liability than would the ongoing basis—and certainly would for a career average plan.

6.4 Describe how “surplus” is defined in pension legislation. (Reading D, Excerpts From CPM, Chapter 11, Pension Plan Surplus Sections 11.1 and 11.2(e), Study Guide Module 11, pp. 67 and 70-71)

A pension plan is said to be in surplus when there is more money in the plan than is required to support its liabilities.

Pension legislation definitions of “surplus” agree with this understanding of what surplus is, but some of them stipulate that certain valuation assumptions be used. Since some of these definitions stipulate that certain valuation assumptions be used, the definitions should be consulted when other provisions of the legislation dealing with surplus are examined. With the exception of Saskatchewan, which does not define “surplus” directly, all jurisdictions define “surplus.” Whatever the legislative definition of “surplus,” no surplus is recognized by a regulatory authority unless it is disclosed in a valuation report prepared by a person authorized to do so under the particular pension legislation.
Describe limitations placed upon sponsors of pension plans holding surplus monies.

7.1 Explain how pension legislation regulates employer surplus withdrawals.
(Reading D, Excerpts From CPM, Chapter 11, Pension Plan Surplus Section 11.4(a), Study Guide Module 11, p. 74)

Pension legislation regulates employer surplus withdrawals to protect the solvency of the pension plan and to protect employees’ potential or actual rights to surplus. Many jurisdictions require that if a withdrawal is made by an employer from an ongoing plan, a portion of the surplus be left in the plan. Employees are generally given the right to be notified of the employer’s application to withdraw surplus from a pension plan. The employer is under an obligation to provide some essential information to employees, such as the total amount of surplus in the plan and the amount sought to be withdrawn. Many of the notification requirements are similar, whether the withdrawal application is made in an ongoing plan or a plan termination situation.

7.2 Explain the primary interest of the courts with cases concerning pension surplus withdrawals and describe issues that can make this task difficult.
(Reading D, Excerpts From CPM, Chapter 11, Pension Plan Surplus Section 11.4(b), Study Guide Module 11, pp. 75-76)

The courts are primarily interested in determining the intention of the parties, as evidenced by the terms of the historical plan documentation, including both the primary documents (i.e., the plan text, funding contract and any collective agreement) and any secondary documents (i.e., employee booklets and annual employee pension statements).

The work of the courts can be difficult because:

(a) Plan documents do not clearly address the issue of surplus because, at the time of their preparation, surplus was not considered a material issue.

(b) Courts often give primary significance to trust agreements that could be off-the-shelf documents, without recognition of the significance of the contents regarding surplus.

(c) Income tax legislation at one time required language indicating that employer contributions must be made irrevocably, never reverting to or for the benefit of the employer.
7.3 **Outline how legislation deals with the issue of the use of plan surplus during the life of a plan.** (Reading D, Excerpts From *CPM*, Chapter 11, Pension Plan Surplus Section 11.5(a), Study Guide Module 11, pp. 77-78)

Some jurisdictions restrict the use of surplus for benefit improvements and/or contribution holidays, based on the plan's specific financial status. The uses to which plan surplus can be put are limited by applicable legislation and administrative rules, by the terms of the plan and by taxation legislation and administrative rules. Apart from the legislative controls, the common law applicable to ownership of the surplus determines whether the use of surplus can be controlled by the plan sponsor or by the plan members.

During the life of a plan, pension plan surplus can be used to improve benefits, to lessen contributions toward current service costs of the plan (i.e., a contribution holiday) or to serve as a contingency reserve against unfavourable financial trends in the future. Some jurisdictions restrict the use of surplus for benefit improvements and/or contribution holidays, based on the plan's specific financial status.

A contribution holiday is the most common use of surplus.

7.4 **Indicate who may receive payments of surplus from a DB pension plan under ITA and the conditions under which such payments would be tax-exempt.** (Reading A, *CPM* and Text Commentary, Study Guide Module 11, p. 34; Reading D, Excerpts From *CPM*, Chapter 11, Pension Plan Surplus Sections 11.7(b) and 11.7(c), Study Guide Module 11, p. 79)

Regulations under ITA permit the payment of surplus from a DB pension plan to any person. Unless the payment qualifies for exemption from tax under ITA transfer rules, the payment is taxable income to the recipient.

Tax-exempt transfers of surplus out of a DB pension plan are permitted when:

(a) The surplus is part of a single amount that is transferred directly to the defined benefit provision of another pension plan to provide a defined benefit on behalf of a transferring employee.

(b) The defined benefit provision is being converted to a money purchase provision, and the surplus not allocated to member accounts is used to satisfy employer contribution obligations under the money purchase provision. All or a significant number of plan members are affected by the benefit conversions and the Minister approves the transfer.

(c) The surplus is transferred directly from a defined benefit provision of an RPP to a money purchase provision of an RPP, where the surplus is credited to members’ accounts under the money purchase provision.
Reading

**Carswell’s Pension Manager (CPM) and Text Commentary**

The *CPM* and Text Commentary expands upon or provides current and relevant applications to the required reading. It should be read in conjunction with the *CPM* and Text readings.

12.2 Asset vs. Share Purchase, Reading B, Study Guide Module 11, Page 35

The majority of this section deals with defined benefit (DB) pension plans. In the case of defined contribution (DC) pension plans, assets and liabilities are usually equal; plan liabilities are determined very simply as the value of member accounts at the date of the sale.

12.2(d) Master Trusts, Reading B, Study Guide Module 11, Page 36

A “master trust” is a pooling of directed and/or discretionary trusts (a “discretionary trust” is one in which the bank is trustee and also has investment responsibility for all or part of the assets). The pure definition is pooling of one sponsor’s assets, which include multiple managers and multiple plans under one trust agreement.

12.4(a)(ii) Valuation Assumptions, Reading B, Study Guide Module 11, Pages 44-45

The CPM material was written when interest rates were higher than they are currently. Given the low-interest-rate environment prevailing from late 2008 to today, the terminating plan basis currently would likely generate a higher plan liability than would the ongoing basis—and certainly would for a career average plan.

12.4(c)(ii)(D) Defined Contribution, Reading B, Study Guide Module 11, Page 51

It should be noted that the statement “Recognition of future service only by the purchaser does not have any effect on the employee’s total pension benefits” is valid only when the purchaser’s DC plan duplicates the contribution schedule of that of the vendor’s DC plan.

11.2(c) Surplus on Plan Termination, Reading D, Study Guide Module 11, Page 67

The CPM material was written when interest rates were higher than they are currently. Given the low-interest-rate environment prevailing from late 2008 to today, the terminating plan basis currently would likely generate a higher plan liability than would the ongoing basis—and certainly would for a career average plan.
11.2(e) Legislative Provisions, Reading D, Study Guide Module 11, Pages 68-69

All Canadian jurisdictions except Saskatchewan directly define surplus within their pension standards legislation. Details of each jurisdiction's definition are not testable exam material.

11.3(b) Provision for Employer Withdrawal of Surplus, Reading D, Study Guide Module 11, Page 70

All pension standards legislations address withdrawal of surplus by the employer. Specifics of all legislations are beyond the scope of this course. For details regarding all surplus withdrawal procedures, refer to the pension standards legislation in the relevant jurisdiction.

Details of legislative requirements are provided as an example for Ontario to illustrate the content covered. Candidates are not required to know the detailed legislative requirements for Ontario—It is provided for illustrative purposes only. It is not testable exam material.

11.5(a) Legislation, Reading D, Study Guide Module 11, Pages 75-76

Note that a number of jurisdictions restrict the use of surplus for contribution holidays, including the regulations for DB plans implemented by Ontario in 2018. These regulations in Ontario also specify the circumstances under which surplus can be used to finance benefit improvements. Benefit improvements are prohibited if a plan is less than 85% funded on a solvency basis or less than 90% funded on a going-concern basis. Any benefit improvement must be fully funded on a going-concern basis within five years of its implementation.

As indicated in Module 4, Ontario’s funding requirements for DB plans added a requirement that restricts the ability of plan sponsors to take contribution holidays to occasions when the PfAD is fully funded, the contribution holiday does not reduce the plan's transfer ratio below 1.05, actuarial certification is filed with the regulator, and plan members are provided with notice that a contribution holiday is being taken. Further, the maximum amount available for use as a contribution holiday is limited to 20% of the plan’s “available actuarial surplus.”
Pension Benefits Guarantee Fund, Text, Pages 461-462

Replace this section with the following commentary:

Ontario is the only Canadian jurisdiction that maintains a guarantee fund in the event that a pension plan is terminated and there are insufficient assets to fund accrued benefits.

The PBGF is administered by the Superintendent of Financial Services. It is funded by a levy imposed on employers with pension plans whose members are subject to the PBGF guarantee. The levy ranges from 0.75%-2.25% of a pension plan's solvency deficiency.

Grossly simplified, the PBGF guarantees the first $1,500 per month in pension benefits that were earned in respect of employment in Ontario. As an example, if a plan is 60% funded, a member either receiving or entitled to receive a pension of $2,000 per month will receive $1,200 per month from the pension plan, but will receive an additional $600 per month from the PBGF to reflect the fact that he or she is receiving only 60% of the first $1,500 of his or her entitlement from the plan.

Certain benefits are not subject to the PBGF guarantee, including benefit improvements granted within the last five years, and prospective indexation increases.
12.1 INTRODUCTION

In the sale of any corporation that sponsors one or more pension plans, the vendor and purchaser must consider the rights and interests of the pension plan beneficiaries and trustees and how they will be affected by the sale. The terms of the sale are generally set out in the purchase and sale agreement which should include specific reference to the disposition of all pension obligations. In addition, the nature of the sale — either assets or shares — will have a direct impact on the obligations of the purchaser and vendor under the pension plan. The pension plan can represent a major asset or liability within a corporate sale, depending upon the funded status of the pension plan and on the specific provisions of the plan and related documents. Subject to the terms of the plan itself (and any related documents such as a collective agreement), the terms of the purchase and sale agreement will determine ownership of, and responsibility for, the assets and liabilities of the plan upon completion of the transaction.

The treatment of a pension plan, like the terms of the purchase and sale agreement itself, is subject to the objectives and negotiating skills of both parties and the legislative and legal constraints affecting pension plans. Assessment of the treatment of assets and liabilities, and a review of the accounting implications of the preferred course of action, will also impact on the decision-making process. In many cases, the purchase and sale agreement will provide for interim arrangements to be implemented during the period pending receipt of all regulatory approvals of necessary plan changes, so that the plan can continue to be effectively managed. Finally, while the legislation may place constraints on the treatment of the pension plan, the purchase price can nevertheless be adjusted to reflect the objectives of both parties.

This chapter highlights the more significant pension issues arising on any corporate reorganization.

12.2 ASSET VS. SHARE PURCHASE

12.2(a) Asset Purchase

When the assets of a corporation or business are purchased, as a matter of corporate law the pension liabilities of the corporation would remain with the vendor. However, the purchaser often agrees to assume the liabilities in the purchase and sale agreement. Usually such an assignment of liabilities is accompanied by an assignment of plan assets sufficient to meet the liabilities. The various methods and assumptions used to determine...
what is “sufficient” and the factors involved in deciding whether or not the liabilities will be retained by the vendor or assigned to the purchaser, depend upon the particular transaction in question, and will be discussed later in this chapter. (See Chapter 12.4.) Also impacting on this decision are the nature of the specific trust arrangements and related trust and pension legislation.

12.2(b) Share Purchase

When the shares of a business are purchased, the corporation, as a legal entity, simply continues under the control of the new shareholders. Consequently, a pension plan sponsored by the corporation will continue without any action required by either the vendor or purchaser.

12.2(c) Multi-Employer Pension Plans

If, prior to the sale, the vendor was a participating employer in a multi-employer plan, typically established for unionized employees, the purchaser will step into the shoes of the vendor as participant in the multi-employer plan as a result of the “successor rights” provisions of the applicable labour relations legislation (see Chapter 12.6). This is the simplest solution for industry-wide negotiated plans, as it satisfies both the terms of the collective agreement and any other related union issues. The assumption of liability under these plans is generally not an issue since the employer’s liability is usually limited to making the contributions required under the applicable labour agreement.

Although most multi-employer plans are established for unionized employees, it is possible to establish them for non-union employees. In this case, the purchaser automatically assumes the contribution responsibilities of the vendor if shares are purchased, or, alternatively, may assume them pursuant to the terms of the purchase and sale agreement if assets are purchased. If, however, the assumption of these responsibilities is not possible (for example, the purchaser is not purchasing the entire business of the vendor or the terms of the multi-employer plan for some reason do not permit it), the purchaser may have to establish a new plan, or provide for the membership of the vendor’s employees in a pension plan already sponsored by the purchaser or a related company.

12.2(d) Master Trusts

Where the vendor’s pension plan trust participates in a master trust along with the plans of other affiliated companies, such participation will necessarily cease upon the sale of the vendor’s business. Regardless of whether it is a sale of assets or shares, unless the purchaser is one of the

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other companies participating (or eligible to participate) in the master trust, the number and value of units held by the vendor’s plan in the master trust will have to be determined and liquidated, and the funds transferred back to the plan trust, or to the trust fund established by the purchaser, if pension plan assets are being transferred pursuant to the purchase and sale agreement.

Depending upon the size of the master trust, it may not be possible to liquidate the vendor plan units in a timely manner, in which case a transfer of funds in specie (i.e., bonds, share certificates), if permitted by the terms of the master trust, can be agreed to by the parties.

12.3 EMPLOYEE RIGHTS

The rights of employees, and the impact of the sale on their employment in general, should form a significant part of any purchase and sale agreement. These rights, both statutory and at common law, and the associated obligations of the vendor and purchaser with respect to the employees generally, and their pension benefits in particular, are discussed below.

12.3(a) Common Law

Where the shares of the vendor company are purchased, the employees’ legal relationship with their employer is not directly affected.

However, a contract of employment is a contract for personal services, and as such is not capable of assignment to the purchaser of assets under common law. As a result, the sale of a vendor’s business triggers the termination of all such contracts (Buchanan v. Canada Valve Inc. (1987), 59 O.R. (2d) 681, 17 C.C.E.L. 273, 39 D.L.R. (4th) 268, 1987 CarswellOnt 905 (Ont. H.C.); White v. Stenson Holdings Ltd. (1983), 43 B.C.L.R. 340, 22 B.L.R. 25, 1 C.C.E.L. 21, 1983 CarswellBC 61 (B.C.S.C.), thereby requiring that reasonable notice be given, and imposing a duty upon the employees to mitigate their losses by seeking alternative employment, and accepting substantially similar employment when offered.

Consequently, where the purchaser “assumes” the employment contracts (whether written or implied) by continuing the employment of such employees without any interruption or material change, no “loss” has been suffered by the employees as a consequence of the termination of their contracts with the vendor. Alternatively, the process can be viewed as a complete and total mitigation of any “loss” which could possibly have been incurred (Addison v. M. Loeb Ltd. (1986), 53 O.R. (2d) 602, 11 C.C.E.L. 100, 25 D.L.R. (4th) 151, 1986 CarswellOnt 836 (Ont. C.A.)). Either interpretation leads to the same conclusion: as no loss has been suffered, no notice is required and any action for wrongful dismissal would be
unsuccessful. If an employee refuses the purchaser’s “offer” of continued employment on the same terms and conditions, it is unlikely a subsequent action for wrongful dismissal would succeed, as the employee has failed to mitigate in good faith.

Where the employees are employed by the purchaser as of the date the transaction closes, the transfer of employment is in practice deemed a *novation* of each individual employment contract, resulting in a total mitigation of damages, and eliminating the necessity to provide notice. A novation occurs when an existing contract is replaced with a new one, often involving the substitution of a new party for an original party, but always with the consent of all of the parties involved.

However, a material change in any term of employment could result in the employees claiming that their contract of employment has been unilaterally altered by the purchaser, possibly providing them with grounds for a wrongful dismissal action.

Although what constitutes a “material change” in the terms of an employment contract is a question of fact to be determined in each individual case, a significant change in the provision or level of benefits, is generally recognized to be a material change. Where the purchaser provides benefits which are superior in all or even most respects to those provided by the vendor, there is little likelihood of a complaint being made or lawsuit being commenced by the employees as a result of the “change” in benefits.

In any event, the vendor usually requires, as a term of the purchase and sale agreement, that the purchaser agree to provide the employees with compensation and benefits substantially similar to those provided by the vendor. Where the vendor sponsors one or more pension plans, the purchaser will often be required to maintain such benefits for a specified time period, e.g., one year following the effective date of the sale, by either assuming sponsorship of the vendor’s plan(s), where appropriate, establishing a new plan, or, alternatively, ensuring the same level of benefits within a plan which the purchaser already sponsors.

Where the purchaser intends to provide formal offers of employment to the vendor’s employees, the language contained in the offers is critical. This is illustrated in *Lawrie v. Deloro Stellite (1993), 45 C.C.E.L. 261, (sub nom. Lawrie v. Deloro Stellite Division of Cabot Canada Ltd.), 1993 C.E.B. & P.G.R. 8145*, a decision of the Ontario Court of Appeal. In that case, the purchaser had offered the employees employment on the same terms and conditions as they had been employed with the vendor. Since the employees had had the sole right to surplus in the vendor’s plan, the Court of Appeal interpreted the wording of the offers to mean that the employees would continue to be entitled to the surplus under the purchaser’s plan (to
which they had transferred), even though that plan gave the purchaser exclusive rights to surplus. In further support of this interpretation, the Court of Appeal noted that the purchaser had reiterated its position in its Staff Personnel Manual, which stated that there was no change in pension benefits when the acquisition took place.

The purchaser should therefore carefully consider the potential implications of any representations which it intends to make to the vendor’s employees, in the context of its purchase of the vendor’s business. As the Lawrie v. Deloro Stellite decision illustrates, such representations may have unintended and far-reaching consequences.

It should be noted that the purchaser is not forever tied to the benefits provided by the vendor. With sufficient notice to the employees (the length of such notice to be determined by the extent and degree of change), the purchaser can usually alter the level and type of benefits enjoyed by the employees, provided that benefits accrued by the employees up to the effective date of the change are not reduced.

12.3(b) Statutory Rights

12.3(b)(i) General

The pension rights of employees upon the sale of all or a portion of a vendor’s business or undertaking are, with few exceptions, specifically provided for in the relevant provincial and federal legislation. Such legislation preserves entitlement to the benefits accrued to the date of sale, and recognizes service with both the vendor and purchaser in determining eligibility for, and vesting of, benefits under both the vendor’s plan and the purchaser’s plan (where the purchaser continues to provide pension benefits after the sale).

12.3(b)(i)(A) Accrued Benefits

Generally, where a vendor who contributes to a pension plan sells, assigns or otherwise disposes of all or a portion of its business or business assets, a member of the pension plan who continues employment with the purchaser continues to be entitled to those benefits accrued under the vendor’s plan to the effective date of the sale.

Although Section 61 of the Saskatchewan Pension Benefits Act, 1992 does not specifically preserve entitlement to benefits accrued to the date of sale, it does provide the Superintendent with the right to terminate a predecessor employer’s plan where:

(A) an employee of the predecessor employer becomes an employee of the successor employer; and
(B) the successor employer does not assume responsibility for the accrued benefits of the predecessor employer’s plan.

An employee’s rights on plan termination under the Saskatchewan Act include the right to any benefits accrued to the date of termination.

The vendor remains liable for the provision of these benefits, which are payable from the vendor’s plan, or through the purchase of an annuity by the pension fund, usually where the vendor’s plan is being wound up as a consequence of the sale. This liability cannot be transferred or eliminated. Nevertheless, the purchaser may agree to administer the pension benefits accrued under the vendor’s plan, usually upon the assignment of assets to the purchaser’s plan or adoption of the sponsorship of the vendor’s plan.

12.3(b)(i)(B) Eligibility and Vesting

The employment of employees who continue with the purchaser is deemed not to be terminated. Therefore, regardless of whether or not the purchaser assumes liability for the accrued pension benefits under the vendor’s plan, the “service” of an employee will include service with both the vendor and purchaser when determining:

1. the vesting of benefits under either the vendor’s or purchaser’s pension plan; and
2. eligibility for membership in the purchaser’s pension plan.

Obviously, where assets and liabilities are transferred to the purchaser’s plan or where the purchaser assumes sponsorship of the vendor’s plan (so that the employee is not entitled to benefits from two plans in respect of the same continued employment), these vesting and eligibility provisions of the pension legislation are less relevant. However, they will continue to operate if the terms of eligibility and vesting are different under the vendor’s and the purchaser’s plans, and the purchaser maintains these differences in its plan with respect to pre- and post-sale accruals.

As the employment of a transferred employee is deemed to be continuous, the sale typically does not trigger the termination provisions of the vendor’s pension plan which entitle the employees to withdraw required or voluntary contributions, and exercise their portability rights (for further detail, see Chapter 3.8(d)). Note, however, that portability may be available to a transferred employee in some circumstances. For instance, Section 58 of the 1996 British Columbia Pension Benefits Standards Act and Section 25 of the British Columbia Pension Benefits Standards Regulation were amended in 1999 to allow an employee to commute past service benefits in some instances where there is no wind-up of the vendor’s plan and the purchaser does not assume responsibility for those past service benefits. Part 9

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For a more detailed description of the provisions of the various provincial and federal legislation dealing with pension benefits upon the sale or reorganization of a vendor’s business, refer to the following sections:

4. Manitoba Pension Benefits Act, R.S.M. 1987, c. P32, s. 34;
5. New Brunswick Pension Benefits Act, S.N.B. 1987, c. P-5.1, s. 69;
7. Nova Scotia Pension Benefits Act, S.N.S. 2011, c. 41, ss. 106-110 (in force June 1, 2015);
8. Ontario Pension Benefits Act, R.S.O. 1990, c. P.8, ss. 79.1-81;
9.* Prince Edward Island Pension Benefits Act, S.P.E.I. 1990, c. 41, ss. 84-85;
10. Quebec Supplemental Pension Plans Act, R.S.Q. c. R-15.1, ss. 194-197;

* Act not yet proclaimed. Current pension legislation does not deal with pension benefits on the sale of vendor’s operations.

12.4 EMPLOYER ISSUES

In discussing the employer issues, both purchaser and vendor will see themselves as the “employer” for some element of the sale transaction. In general, each will wish to meet all legal requirements relating to the rights of the employees. In addition, each will attempt to conclude the sale of the business or division on terms which are most advantageous to him. In negotiating on the pension plan, there is a wide range of possible treatments, each with positive and negative features. The future plans for the business as well as the reasons for the sale can lead to very different negotiations from one sale to the next. In order to illustrate the major issues to be considered, the following example sets out a fairly common treatment of a pension plan on the sale of a corporation. Because of the almost infinite
Profile of a Sale

Corporation B is in the process of acquiring Corporation A through purchase of its assets.

Corporation A has a career average defined benefit pension plan.

Corporation B has a career average defined benefit pension plan which is regularly upgraded to a “current” salary base.

Intent of the Parties to the Sale

The parties to the sale wish to move responsibility for all pension benefits (and control of the plan) to the purchaser. Both parties wish to comply with the law and to avoid major changes which might lead to wrongful dismissal actions by the employees.

Corporation A wishes to transfer the minimum amount of assets required to provide for the accumulated pensions at the sale date.

Corporation B wishes to integrate the transferred employees into its compensation and benefits system, while controlling costs and retaining maximum flexibility for the treatment of these employees.

Terms of Purchase and Sale Agreement

Corporation A will transfer the pension fund to Corporation B. Any excess (or deficit) of the pension fund assets over termination value of the pension plan liabilities on the transfer date will be reflected in an adjustment to the sale price.

Corporation B will provide benefits for service with Corporation A which are equal to the benefits accrued under Corporation A’s pension plan. These benefits will be frozen and Corporation B will not be obligated to provide any benefit improvements with respect to this service period.

Corporation B will transfer the pension fund assets into its pension plan and amend the pension plan to provide benefits to the transferred employees equal to the benefits accrued under the predecessor employer’s pension plan. The transferred employees will become members of Corporation B’s pension plan on the sale date. Corporation B will recognize service with Corporation A for determining eligibility for plan membership and for vesting and locking-in of all benefits accrued under the merged pension plan.

This fairly simple example highlights a number of the issues which

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must be considered in structuring the purchase and sale agreement. The major concerns relating to the pension plan are set out here.

12.4(a)  Structuring the Purchase and Sale Agreement

12.4(a)(i)  Future of the Plan

As discussed briefly above, upon the “sale” of all or part of the vendor’s business, the pension plan may be:

1. terminated by the vendor; 
2. retained and continued by the vendor; or 
3. transferred, together with the pension fund, to the purchaser.

The term “sale” is used here to include any form of distribution or reorganization of all or a portion of the vendor’s business or operation, e.g., wind-up of a division into the parent, discontinuance of the division’s operations, merger of the division with one or other divisions of the corporation, sale of a division or operation to a third party or the complete sale or termination of the vendor’s business.

Obviously, the nature of the sale or reorganization will, to a large extent, determine which options with respect to the vendor’s pension plan are both available and appropriate.

If all of the vendor’s business, or a division with its own pension plan, is being sold, the vendor will likely terminate the plan and purchase annuities to provide the benefits accrued under the plan, or transfer sponsorship of the plan to the purchaser.

If only a portion of the business is being sold, however, and the vendor will continue in business with employees who are participating in the plan, the vendor will usually continue the pension plan and either retain the liability for the benefits accrued to the date of sale by the transferred employees, or, alternatively, transfer assets equal to the liabilities for such benefits from the plan fund to the fund of the plan sponsored, or to be established, by the purchaser.

The possible treatment of benefits accrued to the date of sale is a complex subject which is discussed in more detail in Chapter 12.4(b). In addition, the possible treatment of ongoing or future benefit accruals can vary significantly, based on the types of pension plans involved. This is discussed further in Chapter 12.4(c).

The actual course adopted by the vendor and purchaser will depend upon the facts and circumstances of each individual transaction, as well as the future business intentions of both the vendor and purchaser. Again, the options available and the issues which must be considered will be affected...
by whether or not the assets or shares of the vendor’s business are purchased. As discussed previously in Chapter 12.2(b), where the shares of the vendor company are purchased, the purchaser automatically steps into the shoes of the vendor as sponsor of the vendor pension plan with no further action required by either party. If the purchaser simply maintains the plan, the sale transaction will have no impact or effect on the plan members. However, if the purchaser elects to discontinue the plan entirely, or merge it with a plan which it already sponsors, many of the same issues arising in the context of an asset sale will have to be considered and resolved.

Consequently, many of the issues discussed in the remainder of this chapter will be primarily applicable to asset sales and will have only limited application, if any, where the shares of the vendor company are being purchased. As each individual transaction has features particular to the specific sale, the relevance of the issues raised must be determined on a case-by-case basis.

12.4(a)(ii) Valuation Assumptions

When determining the value of the assets of a pension plan, or the liabilities and associated assets to be transferred from the vendor’s to the purchaser’s plan, the valuation assumptions used in the calculations should be agreed upon by both parties. Otherwise, large discrepancies in the values determined by each side can occur. The acceptability of the assumptions to the pension authorities should also be assessed and may lead to some modification of the initial assumptions (see Chapters 5.6, 5.7 and 5.8 for more details on valuation assumptions).

Basically, valuations can be conducted on a continuing (or “on-going”) basis or on a terminating plan basis.

The plan termination basis usually results in lower values. Although sufficient to provide the benefits at market value at time of sale, the interest assumptions used will be higher and the assumptions relating to salary growth (in final average earnings defined benefit plans) will be zero. Consequently, if the purchaser assumes liability for benefits accrued under the vendor’s plan, and receives a transfer of assets determined on a plan termination basis, the purchaser’s plan could have an unfunded liability when the liabilities are later valued on an “ongoing” plan basis.

Conversely, assumptions on a continuing or ongoing plan basis generally provide higher values, as they will likely include more conservative economic assumptions as well as some level of projection for future salary or benefit increases, which increase the level of accrued liabilities.

Where the purchaser is administering the benefits accrued under the vendor’s plan, it will want ongoing plan valuation assumptions to be used, particularly where benefits have accrued on a final average earnings
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basis. This minimizes the potential unfunded liability in the purchaser’s plan.

Conversely, the vendor will prefer a plan termination basis of valuation, to minimize the value of assets transferred to the purchaser’s plan, and, again depending upon the vendor’s future plans, maximize any potential surplus reversion to the vendor. Nevertheless, because of its continuing legal liability to the employees for payment of pensions accrued up to the date of sale, the vendor in an asset sale will want to be reasonably confident of the purchaser’s ability to pay the pensions. The issue of surplus assets in the context of a purchase and sale are discussed in Chapter 12.4(a)(iv).

The valuation assumptions used also have broader implications in the entire sale transaction itself. Now that accounting principles require the status of the pension plan and expense to be disclosed in the company’s financial statements, the vendor will prefer to use plan termination assumptions to minimize liabilities and encourage a higher sale price. Conversely, the purchaser will favour ongoing plan assumptions, not only for the reasons discussed above, but to reflect higher liabilities and possibly reduce the purchase price.

Consequently, as stated at the outset, it is to the advantage of both parties to agree upon the actuarial valuation assumptions to be used, and to document them in the purchase and sale agreement itself.

12.4(a)(iii) Accounting and Expensing Concerns

Because of current accounting practice, the costs of expensing and funding a pension plan are not necessarily the same (see Chapter 8). In any purchase and sale situation, both the purchaser and the vendor should assess the impact of the transaction on their own expense and balance sheets. From the vendor’s point of view, the transaction may give rise to a curtailment and/or settlement of expenses. From the purchaser’s point of view, the application of its expensing and accounting practices may result in different expense levels than those incurred by the purchaser in the past, which should be reflected in its evaluation of the purchase price. In addition, the vendor may have an asset or liability on the balance sheet as a result of expensing an amount different to the cash contribution. The “value” of this asset or liability needs to be assessed in the determination of the final balance sheet before closing.

12.4(a)(iv) Surpluses and Unfunded Liabilities

A purchaser should be particularly alert to the existence of a surplus (or a deficit) in the vendor’s pension plan. At first glance, a surplus would appear to be a further asset of the plan which would have to be paid
for by the purchaser. However, in view of the current uncertain legal status of pension plan surplus, this assumption may not be appropriate (see Chapter 11.4(b)). If the purchaser has paid for the surplus on the assumption that it is an asset that it can use, and it is ultimately decided that the surplus belongs to the employees, the purchaser will have paid for an asset it cannot realize. Consequently, a purchaser must be vigilant in examining the terms of all versions of the vendor’s pension plan and all associated documents (e.g., trust agreements, insurance contracts, employee booklets and statements, collective agreements, etc.) to determine the treatment of surplus, and further, whether any surplus that might appear to be available to the purchaser ought to be discounted by the probability that court decisions and legislative changes (such as the current Ontario regulation on surplus withdrawals for ongoing plans) will make it difficult, if not impossible, for the purchaser to withdraw surplus.

Conversely, the vendor is likely to take the position that the purchaser will be able to use the surplus to reduce its contributions or to take “contribution holidays,” which will have considerable value to the purchaser and should be reflected in the purchase price. However, there is currently some controversy regarding plan sponsors’ right to use surplus to take a contribution holiday. It is possible that future court decisions and legislative changes will prohibit or severely limit a plan sponsor’s right to take contribution holidays. Also, if, for example, the purchaser’s business plans involve the wind-up of the pension plan at some point within the next few years, the ability to take contribution holidays, even if the practice continues to be permitted, becomes less “valuable.”

Unfunded liabilities are quite common, resulting from benefit upgrades, past service pensions and pensioner improvements which are usually amortized over 15 years, the maximum funding period.

The existence of unfunded liabilities in the vendor’s plan poses a different problem for the purchaser. The purchaser may simply require a reduction in the purchase price to reflect the fact that it will have to fund these liabilities in the future. On the other hand, the unfunded liabilities may be so large that their existence causes the purchaser in an asset purchase to refuse to adopt the plan, opting instead to leave the responsibility for past service with the vendor, and set up its own plan to provide benefits for future service only. Of course, this option is not available to the purchaser of shares, as the corporation will retain, along with all the other liabilities of the corporation, the entire liability for the pension plan.

12.4(b) Benefits Accrued to Date of Sale

A purchaser is under no obligation to assume the liability for pen-
sion benefits accrued up to the date of sale. Consequently, the vendor and purchaser have a number of options available to them when finalizing the pension arrangements.

12.4(b)(i)  Assets Remain With Vendor

Frequently, the vendor will continue to administer pension benefits accrued to the closing date. Thus, there is no transfer of assets from the vendor’s plan.

The purchaser will generally establish a new plan for the transferred employees unless they are to become members of the purchaser’s existing plan. Where a new plan is established, it may be advisable for the vendor to require, as a term of the sale agreement, that the new plan continue the level of benefits provided by the vendor’s plan for a specified period, e.g., one or two years, in order to minimize the possibility of future law suits by former employees on the basis of a material or significant change in their employment contract. (See Chapter 12.3(a).)

Whether the transferred employees become members of a new or existing plan, it is not required to recognize past service with the vendor for the purposes of benefit accruals (as opposed to eligibility for and vesting of benefits already accrued): e.g., the purchaser’s plan need not recognize past service but simply commence accrual of pension benefits by the transferred employees from the sale date forward, as it would for any new employee to the company.

However, where the purchaser’s plan does recognize benefit accrual for past service with the vendor, the employee’s total benefit will most commonly be calculated under the purchaser’s plan, and then offset by the benefit payable from the vendor’s plan in respect of the period of service with the vendor. This is often referred to as a “wrap-around” arrangement, because benefits payable from the purchaser’s plan “wrap around” those payable from the vendor’s plan. (See Chapter 12.4(c).)

In addition, where the vendor retains the assets and liabilities for the pre-sale service, a partial wind-up (as of July 1, 2012, partial wind-ups are no longer permitted in Ontario) or complete wind-up of the successor (purchaser’s) pension plan in respect of some or all of the transferred employees may, in some jurisdictions, trigger a partial or complete wind-up of the predecessor (vendor’s) pension plan, even when the wind-up occurs several years after the sale of the business (GenCorp Canada Inc. v. Ontario (Superintendent of Pensions) (1998), 17 C.C.P.B. 268, 158 D.L.R. (4th) 497, 39 O.R. (3d) 38, 37 C.C.E.L. (2d) 69, 1998 CarswellOnt 1036 (C.A.), leave to appeal to Supreme Court of Canada refused (October 15, 1998), Doc. 26626, [1998] 2 S.C.R. vii (note) (S.C.C.)). This may have sig-
significant implication for the vendor, particularly in jurisdictions such as Ontario where a wind-up confers special rights, such as grow-in, on affected members.

12.4(b)(ii) Assets Transferred to Purchaser

The vendor and purchaser may agree to a transfer of assets and liabilities from the vendor’s plan, to an existing, or newly established plan of the purchaser. (See Chapter 12.4(a) for a discussion of valuation issues arising in a transfer of assets and liabilities.) By accepting a transfer of the liability in respect of accrued benefits, the purchaser agrees to provide for benefits accrued in respect of service prior to the date of transfer. Nevertheless, this agreement does not eliminate the vendor’s responsibility for the provision of benefits accrued before sale. If the purchaser opted to provide the pre-sale benefits, the vendor would nevertheless remain liable to the plan members at common law for benefits accrued by them while they were employees of the vendor. The entitlement to benefits accrued to the date of sale is a right the employees have “in contract” and the liability of the vendor under the contract (of employment) to provide these benefits is not negated by the assignment of the assets to the purchaser. In the event insufficient assets are transferred, the purchaser becomes bankrupt or the funds are misappropriated by the purchaser, the employees can look to the vendor (assuming it still exists) for satisfaction of their entitlement to benefits accrued to the date of sale under the vendor’s plan. Consequently, most vendors require an indemnity from the purchaser in the sale agreement itself and make any transfer of assets conditional upon the establishment and registration of the purchaser’s plan (unless there is an existing plan to which the assets may be transferred, and from which benefits will be payable). However, should the purchaser become bankrupt, it is unlikely the vendor would realize on the indemnity. Although this scenario occurs relatively infrequently, it is still a risk of which the vendor should be aware.

12.4(b)(iii) Regulatory Guidelines

Where the parties to the transaction wish to transfer assets from the vendor’s to the purchaser’s plan, the prior approval of the regulatory authorities is required. Such prior approval and consent to the transfer allows the regulatory authorities to ensure the protection of pension and other benefits to which the members and former members of the vendor’s plan are entitled. Chapter 12.5 below discusses the regulatory issues which arise where assets and liabilities are to be transferred to the purchaser, including a description and explanation of the documentation that must be filed by the vendor and purchaser with the applicable pension regulator as part of
the application seeking approval for the pension asset transfer. In addition, the regulatory guidelines in many jurisdictions focus on whether a surplus or deficit exists in the vendor’s pension plan, and contain written directions respecting the amount of related surplus which may or may not be transferred along with the transferring plan members, as well as the amount of funding which may be required in the event that there is a deficit in the vendor’s pension plan.

12.4(c) Ongoing Benefits

The purchaser’s plan, either new or existing, may recognize all service with the vendor and the purchaser, or recognize future service from the date of closing only.

12.4(c)(i) Recognition of All Service

Often the vendor and purchaser agree that the purchaser’s plan will recognize both past and future service, and will then offset any benefit provided by the vendor’s plan. This eliminates any break in accrual which may result from the sale (discussed below), and consequently, where the two plans have identical terms, an employee’s total pension benefit from both plans will be the same as the benefit he or she would have received from the vendor’s plan had the employee remained a member until retirement.

Referred to as a “wrap-around”, this arrangement has both advantages and disadvantages for both parties. The responsibility for funding benefits accrued to the date of closing remains with the vendor. In this way, benefits accrued to the sale date are preserved, eliminating the vendor’s exposure to subsequent legal action by the transferred employees for a breach of their employment contract on the basis that promised benefits are not fully provided for by the purchaser. In addition, by not transferring assets to the purchaser’s plan, the solvency of the vendor’s plan will not be jeopardized by a large payment out of the plan.

If the vendor’s and purchaser’s plans are career average earnings or flat benefit plans, then generally the purchaser will not create an unfunded liability within its plan as a result of the wrap-around arrangement. The portion of the benefit accrued by the transferred employees under the vendor’s plan will be fully provided for by the vendor’s plan, and the purchaser will basically be funding for future benefit accruals.

However, if the plans are final average earnings plans, then wage or salary increases in future years of service will in effect increase the value of the benefit accrual in prior years. Consequently, in a wrap-around arrangement, by recognizing all service and offsetting the portion to be provided by the vendor’s plan (which is usually calculated and frozen as of the date
of sale), the purchaser’s plan will assume the cost of the upgrade related to service with the vendor.

The same result occurs when the plans are flat benefit or career average earnings plans that are regularly upgraded. In such a case, the plans operate very much like a final average earnings plan. In addition, further unfunded liabilities for which the purchaser is responsible may also arise, depending on the manner in which the accrued benefits under the vendor’s plan were valued (see Chapter 12.4(a)), and whether the purchaser’s plan subsequently upgrades benefits in respect of the years of service with the vendor, or alternatively, for all years of service.

12.4(c)(ii) Recognition of Service from Date of Closing Only

If only future service is to be recognized by the purchaser’s plan, then upon retirement, an employee will receive pension payments from the purchaser’s plan for service from the date of sale, and also from either the vendor’s plan or an annuity purchased by the vendor (unless his pension credit has been commuted and transferred to another plan or RRSP) in respect of service prior to the sale. The effect of this separation of the accrual of pension credits on the total amount of pension benefits the employee will ultimately receive will depend, to a large extent, on the type of plan sponsored by the vendor, the type of plan, new or existing, sponsored by the purchaser, the upgrades, if any, implemented by the vendor and/or the purchaser and whether any upgrades granted by the vendor after the sale to remaining members were made applicable to the transferred employees.

12.4(c)(ii)(A) Final Average Earnings Plans

A final average earnings plan bases a member’s pension upon the member’s length of service and his or her final average earnings over a specified period immediately before retirement, usually the average of the member’s 3 or 5 highest years of earnings in the last 10.

Where pension credits are held in both the vendor’s plan and the purchaser’s plan, the pension credits accrued under the vendor’s plan are typically based on final average earnings at the time of sale rather than final average earnings at the time of retirement. This results in lower pension benefits for the initial period, because the benefit accrued in the vendor’s plan is effectively frozen as of the date of sale, and, consequently, any salary increases granted by the purchaser will not be considered in the benefit calculation under the vendor’s plan. As a result, the pension credit attributable to a year of service with the vendor will be lower than the pension credit attributable to a year of service with the purchaser, because the earn-
12.4(c)(ii)(B) CORPORATE REORGANIZATIONS

ings level applicable to those years will be less than that applied to the years of service under the purchaser’s plan.

12.4(c)(ii)(B) Career Average Earnings Plans

A career average earnings plan provides a pension for each year of service equal to a specified percentage of a member’s earnings in that year. The benefit calculation considers equally the earnings of the member in each year of employment, as the average of all earnings is used, rather than those earnings immediately prior to retirement. Future salary increases do not increase accrued benefits, and, consequently, the purchaser not recognizing past service does not impact on the employee’s total pension benefits. Often, however, career average plans are often periodically upgraded to the level of earnings in a particular year: for example, for all years of service prior to 1983, the average of the employee’s earnings in those years will be deemed to be the 1983 earnings. Such upgrades, if implemented by the vendor after the sale date, may not be applicable to the transferred employees, as their benefit entitlement under the vendor’s plan was calculated and likely frozen at that level at the date of sale. (Even when the purchaser is required by the sale agreement to include credited service with the vendor when upgrading the purchaser’s plan, the amount or timing of the upgrades may vary from those granted by the vendor.)

12.4(c)(ii)(C) Flat Benefit Plans

Technically, flat benefit plans provide a pension equal to a specified dollar amount for each year of service, without regard to earnings levels, either current or future. Usually, recognition of future service only by the purchaser does not have any effect on the employee’s total pension benefits. However, these plans are also subject to periodic upgrades to a certain dollar level for all years of service, usually at the time of negotiations of collective bargaining agreements, and transferred employees often will not benefit from these future upgrades.

12.4(c)(ii)(D) Defined Contribution

If the vendor’s plan is a defined contribution or money purchase plan, contributions are simply deposited to the credit of the employee. The benefit provided is the amount of pension such contributions plus investment income will purchase. The employer contributes to the plan in accordance with the plan text formula. Recognition of future service only by the purchaser does not have any effect on the employee’s total pension benefits.
12.5 REGULATORY GUIDELINES FOR ASSET TRANSFERS

12.5(a) Introduction

The transfer of assets from a pension fund to another pension fund or investment vehicle may occur on a group or individual basis. Group asset transfers may be sought by the employer in several contexts, such as in the sale of a business, a corporate reorganization (e.g., a spin-off), or where the same or related employers wish to transfer assets and liabilities amongst pension plans which such employers sponsor. By contrast, individual transfers will typically be sought by employees who elect to transfer their pension benefits pursuant to a reciprocal transfer agreement or under the regular portability provisions provided by the pension plan and legislation as a result of a change in their employment situation. The regulation of group and individual transfers by applicable pension benefit legislation is set out below.

12.5(b) Overview of Group Asset Transfers

Where an employer wishes to transfer assets from one pension fund to another pension fund, the prior approval of the applicable pension regulatory authorities is generally required. Requiring prior approval of the transfer allows the pension regulator to ensure the protection of pension and other benefits of the members and former members who are affected by the transfer. The legislation and related policy statements focus on whether a surplus or deficit exists in the pension plans involved in the asset transfer, and may prescribe conditions for the inclusion of surplus in the transfer, as well as any funding required if there is a deficit in the plan. Typically, the application to be filed with the pension regulator must include resolutions authorizing the transfer of assets and liabilities out of the original pension plan, and the acceptance of the assets and assumption of liabilities by the successor pension plan, along with an actuarial report or a cost certificate detailing the amount of assets transferred and sufficiency of assets retained for the provision of any remaining benefits.

12.5(b)(i) Standard Legislative Provisions

Many pension benefits Acts (or their related regulations) contain a “successor employer” or “successor plan” provision, or both.

12.5(b)(i)(A) Successor Employer Provision

This provision protects plan members when an employer sells, assigns or disposes of all or a part of its business, and, as a consequence, plan members become employees of the purchaser. It typically provides that, regardless of whether there is a transfer of assets representing the employees’
12.5(b)(i)(B) SUCCESSOR PLAN PROVISION

This provision typically provides that, when an employer stops contributing to the original pension plan and replaces the original plan with a new or existing pension plan, the replacement plan is deemed to be a continuation of the original plan. The successor plan rule will apply in situations such as the merger of two or more pension plans, or the division of a plan into two or more plans, or the transfer of assets and liabilities out of the original plan into a newly registered pension plan.

12.5(c) GROUP ASSET TRANSFERS BY JURISDICTION

The regulations and published policies for group asset transfers in each jurisdiction are set out below. Where there is no written policy or statutory provision, the pension regulator may still require the filing of an application for prior approval of a group asset transfer under the pension statute’s provisions dealing with plan registration, solvency and wind-up procedures. It should also be noted that published policies are not binding on the regulator and are subject to change.

As of July 1, 2011 the Agreement Respecting Multi-Jurisdictional Pension Plans took effect between Ontario and Quebec. The agreement creates asset allocation rules that apply to group asset transfers. Pursuant to the agreement, plan assets must be allocated into jurisdictional portions following a standard allocation methodology. A different allocation may be permitted in some circumstances. The allocation of assets affects the employer liability on wind-up for plans that have Ontario and Quebec members. After assets are allocated as required, the assets are treated according to the rules of the jurisdiction to which they are allocated.

The standard methodology uses levels of priority starting with defined contribution member contributions (including flexible contributions), then core liabilities, other liabilities, additional liabilities and finally, the balance of liabilities. The central concept is core liabilities, which are certain accrued benefits for which solvency funding is required. For example, for an Ontario-Quebec plan, post-retirement indexing is a core liability for Quebec members but not for Ontario members because
ally must be filed with the applicable pension regulator, it is not necessary to obtain prior consent for each individual transfer.

12.6 UNION NEGOTIATED PLANS AND SUCCESSOR RIGHTS

12.6(a) Generally

Where the purchase and sale of all, or part, of a business involves unionized employees who are members of a pension plan, the various provincial and federal labour relations legislation dictates the rights and obligations of the vendor and purchaser.

12.6(b) Successor Rights

“Successor rights” provisions require that a purchaser be bound by the terms of the collective agreement between the union and vendor in effect on the date of sale.

12.6(b)(i) Exception

Most labour relations boards have the right, upon application, to:

1. amend or rescind a collective agreement;
2. amend or revoke any certificate issued to a trade union or council of trade unions; and
3. determine whether employees constitute one or more appropriate bargaining units;

in order to resolve a difficulty or question resulting from the sale.

For a review of the particular successor rights provisions under the various federal and provincial labour relations legislation, refer to the following sections:

1. federal, Canada Labour Code, R.S.C. 1985, c. L-2, ss. 44-46;
2. Alberta, Labour Relations Code, R.S.A. 2000, c. L-1, s. 46;
5. New Brunswick, Industrial Relations Act, R.S.N.B. 1973, c. I-4, s. 60;
7. Nova Scotia, Trade Union Act, R.S.N.S. 1989, c. 475, s. 31;

12-57 (C.P.M.) (2015 – Rel. 2)
Reading

Excerpts From *CPM*, Pension Plan Terminations

THE EMPLOYER’S RIGHT TO TERMINATE THE PLAN

10.3(a) Overview

Most pension plans are terminated by employers themselves, rather than by regulatory authorities, upon passage of a resolution of the board of directors authorizing and directing the termination of the plan. Federally and in New Brunswick, Newfoundland and Labrador, Nova Scotia, Ontario and Quebec, the legislation provides that the employer, or for a multi-employer plan the administrator, can terminate the plan (PBSA – Section 29(4.2), NBPBA – Section 60(1), NLPBA – Section 60(1), NSPBA – Section 73(1), Proposed NSPBA – Section 92(1), OPBA – Section 68(1), QSPPA – Section 204). In Ontario, and on a date to be proclaimed Nova Scotia, if the plan is a jointly sponsored pension plan, the plan terms can assign this responsibility to the administrator or another party (Proposed NSPBA – Section 92(2), (3), OPBA – Section 68(1.1)). In Alberta, British Columbia and Saskatchewan, it is the administrator who notifies the regulatory authority of its intention to terminate the plan (AEPPA – Section 72, BCPBSA – Section 50, SPBA – Section 53). The Manitoba legislation is silent concerning termination other than by the regulator.

When and how these terminations occur, however, depends on the terms of the plan documents. Whether the termination is initiated by the employer, another authorized party or a regulator, the procedures upon termination explained in this chapter are essentially the same.

The documents under which a plan is set up are the primary sources for determining the respective rights and obligations of a person who has an interest in or responsibility for the pension plan. Such a person may be a sponsoring employer, a plan administrator, the funding agent, a regulatory agency, an employee, or other beneficiary. Ideally, therefore, whenever a plan termination is contemplated, anyone who has an interest in the plan should examine the terms of plan documents that might affect the wind-up.

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(C.P.M.) (2014 – Rel. 1)

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10.3(a)(i) PENSION PLAN TERMINATIONS

These documents include the pension plan text and amendments, the funding agreement, any collective agreements, arbitration awards or decrees, employee booklets, statements and other communications – anything that establishes the terms and conditions of the “pension promise.”

It should be noted that the way in which a plan is constituted may affect the rules that will apply upon its discontinuance. For example, a plan established by collective agreement will be subject to labour relations legislation. To the extent that the pension promise is an aspect of the contract of employment, the wind-up could be affected by general principles of contract law and employment law, including employment standards legislation. If the plan is established as a trust for plan beneficiaries, it will be subject to principles established under the law of trusts. If the plan is insured, it will be subject to principles of contract law and insurance law.

Issues related to the ownership of pension plan surplus and issues that arise as a result of the sale, transfer or reorganization of a business are considered in Chapters 11 and 12 respectively.

10.3(a)(i) Termination Provisions Generally

To avoid unnecessary disputes, it is always wise to include detailed termination provisions in the pension plan text and funding agreements. Such provisions should state the conditions under which the plan may be terminated – how, when and by whom – and should provide a scheme of distribution of plan assets and a procedure for discharging plan liabilities. Of course, termination provisions contained in the plan text will be subject to legislative requirements.

10.3(a)(ii) Income Tax Registration Consideration

A pension plan registered under the Income Tax Act must be established as a continuing policy. It may contain an express reservation of a unilateral right of an employer to terminate the plan in whole or in part, or to suspend, reduce or discontinue contributions at any time, but it may not provide for suspension of the plan by the employer. In other words, to maintain registration under the Income Tax Act, provisions that anticipate final dissolution are acceptable; provisions that would render the plan temporarily inoperative are prohibited.

10.3(a)(iii) Employment Law Considerations

The right to terminate may be reserved under a plan that is subject to collective bargaining; however, the continued existence of the plan may
depend upon the continued existence of the related collective bargaining agreement (*Drohan v. Sangamo Co. (No. 2) (1975)*, 11 O.R. (2d) 65, 65 D.L.R. (3d) 15 at 41-52 (Ont. H.C.)).

The primary purpose of a pension plan registered under the Income Tax Act is to provide pensions to retirees in consideration for services they rendered while employees (ITA Reg. – Section 8502(a)). Under common law, a pension arrangement for employees would normally be considered to be a term or condition of employment in any event. Therefore, the right of the employer to terminate the plan will be subject, at the very least, to the express or implied terms of the employment relationship. Those terms may be found in a written or implied contract of employment, minimum employment standards legislation, collective bargaining legislation and employee outlines, booklets or other communications.

A unilateral change to a pension arrangement offered to employees could result in a grievance arbitration or an action for damages.

10.3(a)(iv) Trust Law Considerations

10.3(a)(iv)(A) General Principles


If a plan sponsor reserves the right to terminate a trust agreement under which an employer’s contributions are held for the benefit of employees, actions of the sponsor that are inconsistent with the terms of the continued existence of the trust may constitute a termination of the trust and will trigger any terms of the trust that apply upon termination (*Heilig v. Dominion Securities Pitfield Ltd.* (1986), 1986 CarswellOnt 967, 55 O.R. (2d) 783, C.E.B. & P.G.R. 8020, 29 D.L.R. (4th) 762, 1986 CarswellOnt 967 (Ont. H.C.). Although the Ontario Court of Appeal agreed with that principle, it overturned the lower court ruling and held that two pension plans can be merged without triggering the termination provisions of either plan trust: (1989), 1989 CarswellOnt 120, 67 O.R. (2d) 577, 41 B.L.R. 205, 1989 C.E.B. & P.G.R. 8076, 59 D.L.R. (4th) 394, 32 E.T.R. 77, 33 O.A.C. 229, 1989 CarswellOnt 120, additional reasons at (1989), 69 O.R. (2d) 159, (C.P.M.) (2014 – Rel. 1)
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59 D.L.R. (4th) 394 at 401, 1989 CarswellOnt 2304 (Ont. C.A.). As the merger of the two pension plans was part of the merger of two affiliated companies, it could be distinguished by the Court from the ruling in Reevie v. Montreal Trust Co. of Canada (1986), 53 O.R. (2d) 595, 1986 CarswellOnt 834 (Ont. C.A.), above, where the merger of two pension plans occurred without the merger of the two sponsoring companies, and appeared to be motivated solely by a desire to withdraw surplus assets.


It is possible to terminate a trust other than in accordance with its terms, but it is not entirely clear how general principles of trust law, which permit the variation or termination of trusts, apply to the highly specialized uses of trusts established to support retirement income arrangements. Suffice it to say that there are two general ways in which trusts can be varied or terminated, and each has several variations and a multitude of legal constraints. The basic rules follow.

First, if all beneficiaries can be identified and if they all have legal capacity (i.e., they are adults of sound mind), the trust can be terminated if they all agree. This common-law right is known as the rule in Saunders v. Vautier (1841), 4 Beav. 115, affirmed 41 E.R. 482. In Alberta (Trustee Act, R.S.A. 2000, c. T-8 – Section 42), and Manitoba (The Trustee Act, R.S.M. 1987, c. T160 – Section 59), the court’s approval must be given.

Second, if not all beneficiaries can be ascertained, or if not all bene-
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ficiaries are legally competent, the courts can vary the terms of a trust to address certain inequities. The inherent power of the court to vary the terms of a trust is severely limited and most provinces have comprehensive variation of trusts legislation that provides a complete statutory regime. (See Trustee Act, R.S.A. 2000, c. T-8; Trust and Settlement Variation Act, R.S.B.C. 1996, c. 463; The Trustee Act, R.S.M. 1987, c. T160; Trustees Act, R.S.N.B. 1973, c. T-15; Variation of Trusts Acts, R.S.N.S. 1989, c. 486; R.S.O. 1990, c. V.1; R.S.N.W.T. 1988, c. V-1 (Northwest Territories, Nunavut); R.S.P.E.I. 1988, c. V-1; R.S.Y. 2002, c. 224; The Trustee Act, 2009, S.S. 2009, c. T-23.01.)

Generally, the variation must be for the benefit of plan beneficiaries. In British Columbia, the test is whether the benefit for the person on whose behalf the court is empowered to give the approval is such that a prudent adult, motivated by intelligent self-interest and sustained consideration of the expectancies and risks of the proposal, would be likely to accept the proposal. (See Chapter 11 and Re Sanwell & Co. and Royal Trust Corp. of Can. (1985), 17 D.L.R. (4th) 337, 1985 CarswellBC 683, [1985] B.C.J. No. 2093 (B.C.C.A.).)

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clined to order a termination of the plan, rejecting arguments that it had effectively been terminated already. The Superintendent found that the administrator had the right to re-open the plan and reasoned that the continued existence of the plan was a “worthy goal.” On judicial review of the Superintendent’s decision, the Federal Court ruled that the issue must return to the Superintendent to be decided again, this time taking into account the motive of the plan sponsor and the Superintendent’s duty to plan members (Buschau v. Canada (Attorney General) (2008), 69 C.C.P.B. 182, 2008 C.E.B. & P.G.R. 8310, 2008 CarswellNat 3226, 2008 FC 1023 (F.C.)). The Federal Court of Appeal reversed that decision and upheld the Superintendent’s decision ((2009), 76 C.C.P.B. 161, 2009 CarswellNat 2588, 2009 FCA 258 (F.C.A.), leave to appeal to S.C.C. refused (April 8, 2010), Doc. 33404, 2010 CarswellNat 768 (S.C.C.)). In Lomas v. Rio Algom Ltd. (2010), 81 C.C.P.B. 1, 2010 C.E.B. & P.G.R. 8381, 316 D.L.R. (4th) 385, 259 O.A.C. 333, 99 O.R. (3d) 161, 2010 CarswellOnt 1327, 2010 ONCA 175, the Ontario Court of Appeal held that plan members have no common-law or statutory right to compel termination of a plan in the absence of plan language creating that right. The comprehensive statutory scheme displaces the common law.

If a trust for pension benefits provides for its own termination, it may be terminated only in accordance with its termination provisions unless a variation order is obtained (International Brotherhood of Boilermakers v. Yarrows Ltd. (1963), 39 D.L.R. (2d) 470 (B.C. S.C.)).

10.3(a)(iv)(B) Perpetuities

The “rule against perpetuities” is a trust law concept designed to prevent the tying-up of property for an undue length of time. Generally, under common law, property held under a trust must be dispersed within a period equal to the lifetime of a person in existence at the date the trust was created plus 21 years. The rule has been modified by the evolution of the common law as well as by income tax and trusts legislation. The effect of the rule is that a trust cannot exist longer than the perpetuity period.

The rule against perpetuities, as it applies in the common law provinces, does not apply to pension plans or to trusts established for the purpose of providing pension benefits, except in Prince Edward Island (Perpetuities Act, R.S.P.E.I. 1988, c. P-3 – Sections 1-3). In Prince Edward Island, a trust for pension benefits must vest within a life in being and 60 years. Therefore, a pension plan trust in Prince Edward Island should include a provision for termination within this period.

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10.3(b)(i)  Income Tax Act

Each pension plan registered for income tax purposes on or after 1992 must contain a provision requiring an actuarial surplus to be refunded to contributing employers or paid in cash to the members upon termination of the plan, to the extent that such surplus is not used to provide benefits (ITA Reg. – Sections 8504 and 8503(4)(c)).

This rule has several components. First, surplus that arises upon
10.6(h) **Surplus**

When a plan is wound up, any surplus assets may be distributed among the beneficiaries or revert to the employer, depending on the plan terms and the relevant pension standards legislation. This topic is dealt with in detail in Chapter 11.

10.6(i) **Notice of Benefit Entitlements to Members**

On the wind-up of a pension plan the members, former members, and other persons entitled to benefits must be provided with a statement outlining their benefits and options. This topic is discussed in Chapter 10.5(g).

10.7 **THE EMPLOYER’S LIABILITY ON WINDING-UP**

10.7(a) **General**

Upon termination of a pension plan the employer is required to provide for the pension benefits required under the plan and pension standards legislation before any assets can revert to the employer. The benefits to be paid on winding-up are discussed in Chapter 10.6.

The scheme for provision of pension benefits upon termination of a pension plan must be outlined in the wind-up report that is filed with the pension authority. The wind-up report is discussed in Chapter 10.5(e).

The wind-up report must be approved by the pension authority before any payment or distribution of assets occurs (PBSA – Section 29(7), (10), AEPPA – Section 77(1), BCPBSA – Section 55(1), MPBA Reg. – Section 7.8(3), NBPBA – Section 62(2), (4), NLBPBA – Section 62(2), NSPBA – Section 75(2), Proposed NSPBA – Section 94(2), OPBA – Section 70(2), QSPPA – Section 210, SPBA – Section 56(2)).

There are exceptions to this general rule in all jurisdictions. These exceptions are:

1. payments to continue benefits commencing before the wind-up (PBSA – Section 29(10), AEPPA – Section 77(1), BCPBSA – Section 55(2), MPBA Reg. – Section 7.8(3), NBPBA – Section 62(3), NLBPBA – Section 62(2), NSPBA – Section 75(3), Proposed NSPBA – Section 94(3), OPBA – Section 70(3), QSPPA – Section 210, SPBA – Section 56(5));
2. refunds of employee contributions with interest (PBSA – Section 29(10), NSPBA Reg. – Section 37(5), OPBA Reg. – Section 29(6));
3. payments that are approved by the pension authority (AEPPA – Section 77(1), BCPBSA – Section 55(1), MPBA Reg. – Section 7.8(3), NBPBA – Section 62(3), NLBPBA – Section 62(2), NSPBA – Section 75(3), Proposed NSPBA – Section 94(3), OPBA – Section 70(3)).
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The legislation of Nova Scotia and Ontario makes it clear that refunds of contributions, with interest, are to be paid only to those persons who are not entitled to a pension, deferred pension, or ancillary benefit (NSPBA Reg. – Section 37(5), OPBA Reg. – Section 29(6)). When immediate vesting takes effect in these jurisdictions, this requirement will no longer be relevant.

10.7(b) Funding

All jurisdictions require that upon termination of a pension plan the employer pay into the fund all amounts necessary to comply with the solvency rules up to that date. Some jurisdictions also require the payment of amounts that have accrued to the termination date but are not due to be paid by that date (PBSA – Section 29(6), AEPPA – Section 73, BCPBSA – Section 51, MPBA – Section 26(3), NBPBA – Section 65(1), NLDBA – Section 61(1), NSPBA – Section 80, Proposed NSPBA – Section 99, OPBA – Section 75(1), QSSPA – Section 228, SPBA – Section 54(1)). Minimum funding requirements are discussed in detail in Chapter 5.3.

Generally, the payments scheduled for the unamortized portion of unfunded liabilities or experience deficiencies are discontinued. However, federally and in Alberta, British Columbia, Manitoba, New Brunswick, Newfoundland and Labrador, Nova Scotia, Ontario and Quebec, additional payments will usually be required as explained below.

Federally, upon plan termination the following payments must be made “without delay”:

- normal cost and special payments accrued to the termination date;
- other amounts including deducted employee contributions that are due on or before the termination date;
- prescribed special payments that would otherwise have become due between the termination date and the end of the plan year in which the termination date occurs;
- payments under a workout agreement that are due on termination or would otherwise have become due between the termination date and the end of the plan year in which the termination date occurs; and
- payments required from the employer if a letter of credit has not been honoured by the issuer (in which case the employer must pay the face amount to the plan fund) (PBSA – Section 29(6)).

Additional funding is required over a period of time so that the plan will satisfy its obligations with respect to pension benefits determined as of the termination date. The amount an employer is required to pay is to be paid in a lump sum or over a period of five years from the termination date (PBSA – Section 29(6.1), PBSA Reg. – Section 24.1). If, upon wind-up (ac-
THE EMPLOYER'S LIABILITY ON WINDING-UP 10.7(b)

the valuation distribution of assets), there is a surplus attributable to these contributions, that surplus reverts to the employer (PBSA – Section 29(6.3)).

Upon wind-up of the plan, or upon the liquidation, assignment or bankruptcy of the employer, the amount required to fully fund is payable immediately (PBSA – Section 29(6.4)).

In Ontario, when a pension plan is wound up the employer is liable to pay into the pension fund those amounts required by Section 75 of the Pension Benefits Act:

1. an amount equal to the total of all payments that, under the Act, Regulations and the pension plan, are due or that have accrued and that have not been paid into the fund; and
2. an amount equal to the amount by which the total of
   (a) the value of the pension benefits under the plan that would be guaranteed by the Guarantee Fund if the Commission so declared,
   (b) the value of the pension benefits accrued with respect to employment in Ontario that have vested, and
   (c) the value of the benefits accrued with respect to employment in Ontario resulting from the application of Section 39(3) (50% rule) and Section 74 (wind-up benefits for members whose age plus years of service or membership equals 55),
   exceeds the value of the assets of the pension fund allocated as prescribed for payment of pension benefits accrued with respect to employment in Ontario.

The liability required to be funded under Section 75 of the Act must be funded by annual special payments commencing at the effective date of the wind-up that are at least equal to the greater of:

A. the amount required to fund the employer’s liabilities under Section 75 of the Act in equal payments, payable in advance, over not more than five years; or
B. the minimum special payments required for the year in which the plan is terminated or wound up.

Payments shall continue until the liability is funded (OPBA Reg. – Section 31).

Jointly sponsored pension plans (JSPPs) are exempt from the requirement to fund in Ontario, and on a date to be proclaimed in Nova Scotia (Proposed NSPBA – Section 99(4), OPBA – Section 75.1). Instead, the amounts due on full or partial wind-up (as of July 1, 2012, partial wind-ups were eliminated in Ontario) of a JSPP are those due or accrued to the effect-
11.1 INTRODUCTION

A pension plan is said to be in surplus when there is more money in the plan than is required to support its liabilities. This chapter examines the definition of surplus and the factors that are considered in establishing that it exists. The discussion of surplus is closely related to the funding and valuation methods described in Chapter 5, “Funding and Solvency.”

The large surplus in many pension plans in the 1980s prompted questions of its ownership between employers and their employees. Pension plans have received considerable attention by politicians, the courts, employers and employees. Surplus has become a focal point of concern.

The treatment of surplus is determined by the pension plan, the trust document related to the plan, collective agreements, communications to employees, legislation and court interpretations of all of these. Much of the disagreement about the ownership and legitimate use of surplus today has arisen because of ambiguity or silence in the documentation related to the plan created at a time when surplus was not at issue. This chapter describes the minimum legislative requirements for plan documentation concerning surplus. In order to avoid the problems and misunderstandings that have surrounded the surplus ownership issue, the plan and trust document must accurately and precisely address the treatment of surplus.

In multi-employer plans where the contributions are determined by collective agreement, it is the role of the trustees to determine what benefits can be afforded. Therefore when surplus arises it is typically used to improve the benefits of the members.

This chapter describes the legislation applicable to employer withdrawal of surplus from ongoing and terminated plans.

This chapter also describes the funding uses of surplus in an ongoing plan and considerations concerning surplus payments to members, and deals with the provisions of the Income Tax Act that relate to surplus in pension plans.

11.2 DEFINITION OF SURPLUS

11.2(a) Defined Contribution Plans

The nature of a defined contribution plan is to allocate employee and employer contributions to an account that is invested on behalf of the employee.

Under defined contribution arrangements, surplus is relatively easy to identify and it is usually not significant. At any point in time, surplus in a defined contribution plan is typically that portion of plan assets at-
tributable to employer contributions and the related investment earnings that have been forfeited by terminated plan participants who fail to meet vesting conditions under the terms of the plan. Under the Income Tax Act, each forfeited amount and all attributable earnings must be paid to the employer, reallocated to members or used to pay administrative, investment or similar expenses incurred in connection with the plan, on or before December 31 of the year immediately following the calendar year in which the amount is forfeited (ITA Reg. – Section 8506(2)(f)). Allocation of forfeitures to employees is treated as employer contributions made in the year of the allocation for purposes of pension adjustment (PA) reporting and is subject to maximum contribution limitations. Forfeitures paid to the employer are subject to the requirements of federal and provincial legislation governing withdrawals of surplus by employers described in Chapter 11.4(a).

11.2(b) Defined Benefit Plans

The nature of a defined benefit plan is to promise a benefit payable in the future calculated on the basis of a formula, such as 2% of average earnings over the last 5 years multiplied by years of employment. Various approaches can be taken to funding the plan so that money will be available to provide these benefits when they become payable. These are described in Chapter 5, “Funding and Solvency.” All standard funding methods involve a process of estimating the cost of the plan so that regular contributions to the plan by the sponsoring employer can be made. The treatment of surplus in defined benefit plans is the focus of this chapter.

Surplus in a defined benefit pension plan is the excess of the actuarial value of the plan assets over the actuarial liabilities for the accrued benefits. The actuarial liability is calculated taking into consideration each type of benefit that may become payable to each member of the plan in the future. In order to perform these calculations, assumptions must be made about future events that affect the amount and timing of benefits payable to the plan members. Typically, assumptions are made about future mortality rates, salary levels, retirement ages and employee turnover. Assumptions about future investment returns on the plan funds must also be made. In addition to calculating the actuarial liability, a similar calculation is needed to determine the annual contributions that are required to fund the pension cost that accrues year by year. Chapter 5.6, “Actuarial Assumptions,” and Chapter 5.8, “Asset Valuation Methods,” contain discussion of these aspects of funding.

The assumptions made about future events rarely, if ever, match perfectly with actual experience. Therefore, when a financial assessment,
DEFINITION OF SURPLUS

11.2(c)

or valuation, of a pension plan is made at a given time, the plan will be in either a surplus or a deficit position. When plan assets are greater than the actuarial liability for the accrued benefits to be provided by the plan, the plan has a surplus.

Valuations of pension plans are made for different purposes, and the specific purpose of a valuation will dictate that certain assumptions, or ranges of assumptions be used. There is considerable variation in the quantity of the surplus (or deficit) identified in a plan according to the nature of the valuation which is undertaken.

In particular, the amount of surplus in a plan will differ according to whether the valuation of assets and liabilities is based on a “going concern” or “plan termination” basis. In addition to requiring periodic valuations on a going concern basis, some jurisdictions require ongoing plans to determine surplus periodically on the basis of a “solvency test.” The prescribed requirements of the solvency test are very similar to those of a “plan termination” valuation.

Refer to Chapter 5, “Funding and Solvency,” for details of valuation reporting requirements.

11.2(c) Surplus on Plan Termination

When a plan is terminated, the surplus consists of that portion of the assets not needed to discharge all the obligations for benefits accrued to the termination date according to the plan document, plus any additional benefits that may be required by statute. Benefits become payable, and are calculated from facts in existence, as of the effective date of the termination.

The accrued liability on a plan termination basis is usually lower than on a going concern basis. For example, in a final average earnings plan, projected salary increases are no longer taken into account. Another source of difference between these valuations is that, for a plan termination valuation, the assets are typically assessed at market value, whereas for a going concern valuation, different actuarial estimates of the value of assets may be utilized. Thus, in many situations, the surplus generated on plan termination is greater than that estimated for an ongoing plan. However, in some situations, the additional liabilities that may be imposed by statute as a result of the termination can cause the plan termination surplus to be less than the going concern surplus. Refer to Chapter 10, “Pension Plan Terminations,” for details of these termination requirements.

Surplus can only be established with certainty once all the obligations are not only valued but settled. This generally involves purchasing fully paid-up annuities that will deliver the promised benefits when they

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11.2(d) Surplus in an Ongoing Plan

An ongoing pension plan is said to be fully funded when a going concern actuarial valuation discloses that the actuarial value of the assets exceeds the actuarial liability for the accrued benefits. This balancing of the liability and the assets of the plan is rarely perfect. To the extent that the assets exceed the liabilities at the date of a valuation, the pension plan is said to be in a surplus position at that date. The going concern surplus at any particular time is an estimated amount. The estimate of going concern surplus can vary substantially depending on the actuarial asset valuation method that is used and the actuarial assumptions and methods that are used to determine the actuarial liability for accrued benefits. Therefore, the going concern surplus in a pension plan is not a well-defined amount unless the related methods and assumptions are exactly specified.

Some funding techniques can have an effect on surplus in an ongoing plan. For example, it is possible to reduce the actuarial liabilities and some of the uncertainty by purchasing paid-up annuities or insurance policies to discharge liabilities accrued up to a point in time. The decision to fund benefits in this manner will include consideration of how the rates of investment return from the various insurance products available compare to the expected rate of return the pension fund might produce in the future. Reference should be made to Chapter 5, “Funding and Solvency,” for a more detailed discussion of funding techniques.

11.2(e) Legislative Provisions

In the previous sections of this chapter, surplus is described without reference to legislation. In this section, the definitions of surplus in pension legislation, if any, are described. These definitions agree with the industry understanding of what surplus is, but some of them stipulate that certain valuation assumptions be used and so should be consulted when provisions of the legislation dealing with surplus are being examined. These stipulations may prove to be significant in some circumstances.

Federally, and in British Columbia, Manitoba, New Brunswick, Newfoundland and Labrador, Nova Scotia and Ontario, surplus is defined as the excess of plan assets over plan liabilities (PBSA Reg. – Section 16(1), BCPBSA – Section 1(1), MPBA – Section 1(1), NBPBA – Section 59(1), NLPBA – Section 2(ii), NSPBA – Section 2(al), Proposed NSPBA – Section 2(ba), OPBA – Section 1). In Alberta, this definition applies only in cases of a plan that is being wound up (AEPPA – Section 1(1)(uu)). The Alberta legislation defines another term, “excess assets” (AEPPA – Section
1(1)(p)), which means the amount of assets that exceeds the liabilities in respect of a plan that is not being wound up. Before May 31, 2010, the Manitoba definition of surplus specified that the present value of outstanding special payments was to be excluded from the asset valuation. With the amendments which came into force on May 31, 2010 (pursuant to Bill 10, The Pension Benefits Amendment Act (S.M. 2005, c. 2) and Manitoba Regulation 39/2010), surplus for purposes of an ongoing plan is defined as the excess of the plan’s going concern assets over its going concern liabilities, while surplus for a plan being wound up is the excess of the plan’s solvency assets over its solvency liabilities. “Solvency assets” are defined as including the actuarial present value of any special payments that are payable over the five years following the review date (MPBA Reg. – Section 4.7(1)). The regulations of the Newfoundland and Labrador, Nova Scotia and Ontario legislation specify that for the purposes of determining surplus in an ongoing plan, assets are to be calculated on the basis of the market value of the investments of the fund plus any cash balances and accrued or receivable items and that the plan liabilities are to be calculated as the greater of going concern and solvency liabilities (NLPBA Reg. – Section 19, NSPBA Reg. – Section 34(1), OPBA Reg. – Section 26). For details of the meaning of “special payments” or “solvency liabilities,” refer to Chapter 5.3.

The pension legislation of Saskatchewan does not define surplus directly. The Quebec pension legislation defines surplus for terminated pension plans as the amount by which the value of its assets exceeds the value of its liabilities (QSPPA – Section 230.0.1).

Whatever the legislative definition of surplus, no surplus will be recognized by a regulatory authority unless it is disclosed in a valuation report prepared by a person authorized to do so under the particular pension legislation. Reference should be made to Chapter 2, “Registration and Reporting Procedures,” for details of reporting requirements.

11.3 CONTENT REQUIREMENTS FOR PLAN DOCUMENTS

11.3(a) Registration Requirements

Alberta, British Columbia, New Brunswick, Newfoundland and Labrador, Nova Scotia, Ontario, and Saskatchewan require as a condition of plan registration that information on the treatment of surplus both while the plan is ongoing and on plan termination be set out in the plan text (AEPPA – Sections 28(1)(g), 55(2), BCPBSA – Sections 24(1)(g) and 45(2), NBPBA – Section 10(4)(f), NLPBA – Section 38, NSPBA – Section 11-7 (C.P.M.) (2014 – Rel. 1)
11.3(b) Provision for Employer Withdrawal of Surplus

Under federal, Alberta, British Columbia, Nova Scotia and Ontario legislation, in order to withdraw surplus, an employer must establish its entitlement to do so either pursuant to plan terms, or pursuant to an agreement with the plan members if certain conditions are met (federal — see Chapter 11.4(a)(i), Alberta — see Chapter 11.4(a)(ii), British Columbia — see Chapter 11.4(a)(ii.i), Nova Scotia — see Chapter 11.4(a)(vii)), and Ontario — see Chapter 11.4(a)(viii)).

New Brunswick, Newfoundland and Labrador, Nova Scotia, Ontario and Saskatchewan legislation states that an employer may not receive plan surplus unless the plan permits this to occur (NBPBA – Section 59(4), NLPBA Reg. – Sections 20(2)(b) and 22(b), NSPBA – Section 84(1)(b), OPBA – Section 77.11(1), (2), (3), (4), SPBA – Section 62). However, Newfoundland and Labrador and Nova Scotia legislation also provides that the employer may withdraw surplus from an ongoing plan if the regulator is otherwise satisfied about the employer’s entitlement (NLPBA Reg. – Section 20(2)(b), NSPBA – Section 84(1)(b)). Under the Ontario legislation proclaimed in force on December 8, 2010 and under proposed legislation in
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CONTENT REQUIREMENTS FOR PLAN DOCUMENTS 11.3(b)

Nova Scotia not yet in effect, in lieu of demonstrating that the plan terms provide for the employer’s right to withdraw surplus, the employer may
withdraw surplus in accordance with a written agreement or court order
(Proposed NSPBA – Section 104, OPBA – Sections 77.11(7), 79(1)(b) and
proposed Section 79(3)(b))). This entitlement is subject to compliance with
all the other prescribed requirements for surplus withdrawal (Proposed
NSPBA – Section 104, OPBA – Section 79(1)(b) and Section 79(1)(f)). Ef-
fective May 31, 2010, the Manitoba legislation was amended to provide
that an employer may apply to the Commission to receive plan surplus if a
court has determined that the employer is entitled to surplus pursuant to the
plan terms or the employer has made a proposal, in accordance with the reg-
ulations to members and beneficiaries and has provided the Commission
with the required consents (MPBA – Section 26(2.1)). As before, the
MPBA permits a refund of surplus to the employer without a court order or
member consent if, in the view of the Commission, the plan documents
clearly support the employer’s entitlement (MPBA – Section 26(2.1)(a)(i)).

Quebec legislation does not allow the withdrawal of surplus by an
employer from an ongoing plan. Payment of surplus on a plan termination
is based either on agreement or arbitration (see Chapter 11.4(a)(viii)).

New Brunswick, Nova Scotia and Ontario legislation creates a pre-
sumption against the employer if there is no clear enabling statement for
employer withdrawal in the plan text (NBPBA – Section 59(6), NSPBA –
Section 84(4), Proposed NSPBA – Section 104(2), (3), OPBA – Section
77.11(2), (3)). The Acts of these provinces state that a plan that does not
provide for, shall be construed to prohibit, employer withdrawal of surplus.
This applies both to an ongoing plan or in a plan termination situation
(NBPBA – Section 59(6), (7), NSPBA – Section 84(2), (4), Proposed
NSPBA – Section 104(2), (3), OPBA – Section 77.11(2), (3)). The New
Brunswick provision applicable to surplus on plan termination is effective
from December 31, 1991. The Nova Scotia provision is effective January 1,
1990 and affects accruals from January 1, 1988 for both ongoing and plan
termination purposes. (The original Ontario provision was effective Janu-
ary 1, 1989 and was amended effective December 8, 2010. It affects accru-
als from January 1, 1987 for both ongoing and plan termination purposes.
After these effective dates, amendments to plan documents introducing an
employer right to withdraw surplus are not allowed.

In Ontario, if a pension plan is a successor pension plan and if it is
being wound up in whole or in part, the employer is not entitled to payment
of surplus under the pension plan unless the documents that created and
supported the original pension plan and pension fund and those that create
and support the successor pension plan and fund both provide for payment

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11.4 PENSION PLAN SURPLUS

to the employer on full or partial wind-up, as the case may be, of the pension plan. Note that as of July 1, 2012, partial wind-ups were eliminated in Ontario.

In Ontario, the Superintendent considers an amendment that enhances an employer’s right to withdraw surplus as one that adversely affects the rights of plan members. Therefore, a special notice procedure is a prerequisite to registration of the amendment (OPBA – Section 26). New Brunswick and Nova Scotia have similar notice of amendment provisions (NBPBA – Section 24, NSPBA – Section 32). Refer to Chapter 7, “Disclosure of Pension Plan Information,” for details of these procedures.

Explicit provision for employer withdrawal of surplus is recommended where possible in every jurisdiction in Canada for an employer whose pension plan might generate surplus assets. This will allow the employer the greatest possible flexibility in determining the disposition of surplus, though by itself may not be determinative.

11.4 WITHDRAWAL OF SURPLUS BY THE EMPLOYER

11.4(a) Legislation

Pension legislation regulates employer surplus withdrawals to protect the solvency of the plan and to protect the employees’ potential or actual rights to surplus. Some of the legislation is substantive. For example, many jurisdictions require that if a withdrawal is made by an employer from an ongoing plan, a portion of the surplus be left in the plan. Some of the legislation is procedural. Employees are generally given the right to be notified of the employer’s application to withdraw surplus from a plan. The employer in turn is under an obligation to provide some essential information to the employees, such as the total amount of surplus in the plan and the amount sought to be withdrawn. Many of the notification requirements are similar whether the withdrawal application is made in an ongoing plan or a plan termination situation. In Chapter 11.4(a), requirements that are specific to one or the other will be noted.

An employer should consider whether the laws of any jurisdiction where its plan has members might restrict the withdrawal of surplus. The applicable legislation is outlined below.

Portions of the following discussion are summarized in several tables at the end of Chapter 11.4(a).

11.4(a)(i) Federal

Under the PBPA, an employer is presented with several approaches to obtain a refund of surplus from a pension plan (ongoing or wind-up).
WITHDRAWAL OF SURPLUS BY THE EMPLOYER

11.4(b)

Proposed Sections 77.11(9) and 77.12, arbitration re allocation of surplus on wind-up will be permitted where the Superintendent has not consented to payment of surplus to the employer and no agreement described in Section 77.11(7) has been entered into.

Table 4

Legislative Approaches to Employer Withdrawals of Surplus from a Terminated Plan

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Contractual Entitlement</th>
<th>Member Agreement</th>
<th>Arbitration</th>
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<tbody>
<tr>
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<tr>
<td>Alberta</td>
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<tr>
<td>British Columbia</td>
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<td>Manitoba</td>
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<tr>
<td>New Brunswick</td>
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<td>Newfoundland and Labrador</td>
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<tr>
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<tr>
<td>Saskatchewan</td>
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</tbody>
</table>

*  Bill 120 (S.O. 2010, c. 24), Securing Pension Benefits Now and for the Future Act, 2010, includes provisions for a binding arbitration process for surplus withdrawal on plan termination. These provisions will take effect on proclamation.

11.4(b) Court Cases

In court cases concerning surplus withdrawals, the courts have been primarily concerned with determining the intention of the parties, as evidenced by the terms of the historical plan documentation: both the primary documents (e.g., the plan text, funding contract and any collective agreement) and any secondary documents (e.g., employee booklets, annual employee pension statements). This task is often difficult for many reasons:

1. In many cases, the issue was not considered material at the time the documents were prepared, with the result that the issue was not clearly addressed. Many pension plans have a history of documents that are silent, contradictory, or ambiguous;

2. Other complications arise from the fact that most plan sponsors tended to give primary attention to drafting the plan text, whereas the courts often give primary significance to any trust agreements, which were
11.4(b) PENSION PLAN SURPLUS

often standard “off the shelf” documents signed without appreciation
of the legal significance of their contents;
3. Other complications arise from the income tax legislation, which at
one time required plans, regardless of the employer’s intention, to in-
clude language that the employer contributions to the plan must be
made irrevocably and must not in any circumstance revert to or for the
benefit of the employer. (This irrevocable requirement was deleted in
1972.)

For the common law provinces, the Supreme Court of Canada deci-
dion in the Air Products case (Schmidt v. Air Products of Canada Ltd.,
[1994] 2 S.C.R. 611, 3 C.C.P.B. 1, 1994 CarswellAlta 138, 1994 Carswell-
Alta 746, 4 C.C.E.L. (2d) 1, 3 E.T.R. (2d) 1, 20 Alta. L.R. (3d) 225, C.E.B.
W.A.C. 81, (sub nom. Re Stearns Catalytic Pension Plans) 168 N.R. 81) is
the leading legal precedent. Its primary holdings were as follows:
1. Typically pension plans are funded either through a trust agreement or
insurance policy. The distinction is fundamental to the legal interpreta-
tion of the documents;
2. Where a pension plan is funded by means of a trust agreement, the le-
gal analysis is based on trust law principles;
3. Where a pension plan is funded by means of an insurance policy, the le-
gal analysis is based on contract law principles;
4. These two areas of law are quite different concerning the employer’s
ability to amend the plan provisions concerning surplus entitlement.
The essence of a trust situation is the alienation (transfer) of prop-
erty for the benefit of someone else, and if the person initially contribut-
ing to the plan (i.e., the employer) wants the right to take back the money in cer-
tain situations, then such a significant qualification attaching to the contribu-
tions should be expressed when the trust is originally established. It
cannot be added at a later date merely by use of a general power of amend-
ment in the document. In this case, mere silence in the original documents
would be fatal to an employer’s right to recapture surplus.

In contrast, a situation with an insurance policy is interpreted using
contract law principles. In this case, a general (i.e., unrestricted) power of
amendment would be sufficient to allow the employer to recapture surplus.
In this case, the employer’s ability to change the plan terms is much higher,
typically limited only by early documents that prohibit employer recapture
of surplus irrevocably. In this case even a general power of amendment
would not be sufficient to change a provision that was originally
established on an irrevocable basis.

On July 29, 2004, the Supreme Court of Canada released its deci-
11.5 USE OF SURPLUS IN ONGOING PLANS

11.5(a) Legislation

Apart from the question of ownership and withdrawal of surplus by the plan sponsor, pension plan surplus may be used during the life of a plan in various ways. For example, it can be used to improve benefits, to lessen contributions toward current service costs of the plan or to serve as a contingency reserve against unfavourable financial trends in the future. The uses to which plan surplus can be put are limited by applicable pension legislation and administrative rules, by the terms of the plan and by taxation legislation and administrative rules. Apart from the legislative controls, the common law applicable to ownership of the surplus determines whether the use of surplus can be controlled by the plan sponsor or by the plan members, as described in the preceding section of this chapter.

Reference should be made to Chapter 5, “Funding and Solvency,” for a more comprehensive understanding of the use of surplus in pension plan funding.

Although all pension legislation in Canada allows employers to use surplus to reduce the contributions they would otherwise have to make, the specific requirements and limitations vary to some degree. The most common funding method that makes use of surplus is known as a “contribution holiday.” This is the practice of crediting surplus toward the employer’s con-
USE OF SURPLUS IN ONGOING PLANS

11.5(a)

tribution obligation for current service costs in place of actual payments. The courts’ views on contribution holidays are discussed in Chapter 11.5(b).

All pension legislation provides that a plan can be declared to be terminated in whole or in part if employer contributions cease or are suspended (PBSA – Section 29(2), AEPPA – Section 70(2), BCPBSA – Section 48(2), MPBA Reg. – Sections 7.3(c), 7.4(1)(c), NBPBA – Section 61(1)(a), NLPBA – Section 59(1)(a), NSPPA – Section 74(1)(a), Proposed NSPBA – Section 93(1)(a), OPBA – Section 69(1)(a)*, QSPPA – Section 205, SPBA – Section 51(2), (3)). Alberta, British Columbia, Newfoundland and Labrador, Nova Scotia and Quebec (until 1990) make an explicit exception to this provision for situations where the employer is using surplus to take a contribution holiday.

Under Alberta legislation, funds cannot be transferred between fundholders in respect of the same plan unless the Superintendent has consented to the transfer.**

British Columbia legislation also expressly regulates contribution holidays by an employer (BCPBSA – Section 41(1.2)). An employer may take a contribution holiday if the pension plan has surplus assets and the plan terms provide for a contribution holiday, subject to certain prescribed conditions, one of which is that the contribution holiday must not reduce surplus assets to less than 5% of the value of liabilities under the plan, determined as of the previous review date (BCPBSA Reg. – Section 36(7)).

Newfoundland and Labrador also expressly provides for a contribution holiday by an employer (NLPBA Reg. – Section 21). An employer may take a contribution holiday if a pension plan has a surplus and permits a contribution holiday, provided that the contribution holiday does not reduce the surplus to less than 10% of the value of the liabilities under the plan, determined as of the last review date calculated on the basis of a solvency valuation.

The regulations under the Manitoba pension legislation were amended to provide that, where the most recent actuarial valuation report or cost certificate shows no unfunded liability and no solvency deficiency, surplus may be applied to reduce employer defined benefit contributions, unless expressly prohibited by the plan, provided that the contribution holiday does not reduce the surplus to less than 5% of the plan’s solvency liabilities as of the latest review date (MPBA Reg. – Section 4.27). This same provision permits the application of surplus to reduce member contribu-

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* Effective July 1, 2012, partial wind-ups were eliminated in Ontario.
** The requirement for consent does not apply where all applicable funding documents for the plan have been filed and any relevant amendment to the plan providing for the transfer has been registered (AEPPA – Section 82(2.1)).
11.7(b) PENSION PLAN SURPLUS

(b) all assumptions made for the purposes of the valuation are reasonable at the time the valuation is prepared and at the time the contribution is made, and

(c) where more than one employer participates in the plan, assets and actuarial liabilities are apportioned in a reasonable manner among participating employers;

3. the recommendation is approved by the Minister; and
4. at the time the contribution is made, the plan is not a designated plan.

11.7(b) Distribution and Taxation

Regulations under the ITA permit the payment of surplus from a defined benefit plan to any person (ITA Reg. – Section 8502(d)(vi)). Unless the payment qualifies for exemption from tax under the transfer rules (ITA – Section 147.3) the payment is taxable income of the recipient.

11.7(c) Tax-Exempt Transfers of Surplus

Tax-exempt transfers of surplus out of a defined benefit plan are permitted only where:

1. the surplus is part of a single amount that is transferred directly to the defined benefit provision of another pension plan to provide a defined benefit on behalf of a transferring employee (ITA – Section 147.3(3));
2. the defined benefit provision is being converted to a money purchase provision, and
   (a) the surplus not allocated to member accounts will be used to satisfy employer contribution obligations under the money purchase provision;
   (b) all or a significant number of plan members are affected by the benefit conversion; and
   (c) the Minister approves the transfer (ITA – Section 147.3(8)); or
3. the surplus is transferred directly from a defined benefit provision of a registered pension plan to a money purchase provision of a registered pension plan, where the surplus is credited to member’s accounts under the money purchase provision (ITA – Section 147.3(4.1)).

Tax-exempt transfers of surplus out of a defined contribution plan are permitted where a second defined contribution plan replaces all or part of the first plan and the Minister approves the transfer (ITA – Section 147.3(7.1)).

In all other cases the transfer or payment of surplus is a taxable event. It is of course possible to increase benefits up to the maximum allowable amount before determining the amount of surplus that is involved. However, increases in benefits for years of service prior to the year of im-
FEDERAL INCOME TAX RULES

11.7(c)

Plan amendments and after 1989 will be subject to PSPA reporting and certification requirements (see Chapter 6.8 for details).
Page 2, Assigned Reading, Text: Remove what is crossed out. The section on Pooled Registered Pension Plans is part of the Assigned Reading.

Text
Chapter 13, Chapter 14, Pages 415 to 416 (to Registered Retirement Savings Plans), Pages 425 (from Profit-Sharing Plans) to 426 (to Registered Profit-Sharing Pension Plans), Pages 430 (from Employee's Profit-Sharing Plans) to 434, (to Pooled Registered Pension Plans), Pages 436 to 441