

# 7 Notification Pitfalls to Avoid in Converting DB to DC Plans



If your company still has a defined benefit (DB) pension plan, it's a pretty good bet that you're looking to convert it to a defined contribution (DC) plan. But that's easier said than done. Amending pension plans is never easy; and converting a DB to a DC is anything but a routine amendment. One formidable challenge is notifying current and retired plan members and beneficiaries (which we'll refer to collectively as "members"). If notice isn't proper, members (and pension regulators) might try to block the conversion—or sue you for damages after it takes effect. This article will explain how to provide the right notification.

## **What's At Stake—DB to DC Conversions**

The essence of the DB plan is the promise to pay members a specific benefit upon retirement. DB plans must undergo periodic actuarial valuation to ensure they have the assets necessary to fulfill all these promises. If the plan is running an actuarial deficit, the employer must "amortize" or fund it by a stated deadline.

In DC plans, member's contributions are fixed but the benefit amount isn't. The benefit the member ultimately receives is based on the investment performance of the funds contributed to the plan. And since the plan's liabilities aren't fixed, there are no actuarial deficits that require funding.

Conversion from DB to DC to get out from under the funding burden was desirable even before the investment market collapsed. Dismal market performance and a bad economy only accelerated the trend.

## **THE LAW OF DB TO DC CONVERSION**

You must notify members when you amend a pension plan. The rules vary by province:

**Pre-Registration Notice:** In AB, NB, NS and ON, employers must provide notification of amendments that could adversely affect or reduce members' benefits before registering those amendments with the government. Courts have interpreted this as covering the conversion of a DB plan to a DC. Conversions are deemed potentially adverse because once they take effect, benefits become subject to investment return and there are no guarantees.

**Post-Registration Notice:** In BC, MB, NL, QC and SK, you don't generally have to notify members *before* you register the amendment but must do so *after* the

registration date or effective date. Pension laws may also require administrators to provide not just notice but an explanation or summary of the amendment to all members affected by the amendment. The notice and explanation must include the information that members need to understand what the amendment is about and how it will affect their benefits.

### **The Consequences of Improper Notification**

Failure to provide members proper notice can lead to:

**Delay and Administrative Costs:** In pre-registration notice provinces (and federal law for plans that reduce benefits), failure to serve proper notice can delay the conversion and make it more expensive. Regulators may refuse to accept and register an amendment to convert the plan if the notice is inadequate and require you to rewrite and re-transmit it.

Example: In 1999, an Ontario DB plan adopted an amendment adding a DC component and allowing the plan to use the actuarial surplus in the DB plan to fund it. Members sued, claiming that the notice of the amendment invited members to convert their DB interest to a DC pension without accurately explaining how such a conversion would affect their benefits [*Nolan v. Ontario (Superintendent of Financial Services)*, aka the "Kerry" case].

**Liability for Misrepresentation:** If members are harmed by relying on inaccurate information or omissions in your notice, they could sue using a legal theory called negligent misrepresentation.

Example: A plan offered employees two severance options: a lump sum payment upon immediate termination, or installment payments if they kept working for 16 months. What the plan didn't explain was that the lump sum would cut the benefit by 60% and the installment payments by only 30%. An employee who opted for the lump sum sued upon learning of the impact of his decision on the benefit amount. The court found the employer liable for negligent misrepresentation. Even an honest omission to explain the impact of the options made it impossible for the employee to make an informed decision, a New Brunswick court ruled [*Allison v. Noranda, Inc.*, [2001] N.B.J. No. 241, June 22, 2001].

## **HOW TO COMPLY-7 Notification Pitfalls to Avoid**

### **1. Not Notifying All Affected Parties**

**Pitfall:** Pension laws require plans to give notice of a conversion or other adverse amendment to all plan members whose rights are affected. Failure to give all affected beneficiaries notice can make a notice improper.

**Solution:** Make sure you provide notice to all members whose benefits might be adversely affected by the conversion, including:

- Current members;
- Former members with vested benefits or pensioners who are currently receiving benefits under the plan; and
- Surviving or former pension partners or beneficiaries of deceased members.

### **2. Making Guarantees about DC Benefit Amounts**

**Pitfall:** Converting a DB plan to a DC is almost certain to affect the amount of benefits members receive upon retirement. It might be tempting to deny or understate this impact to reassure members. That's a serious mistake.

**Solution:** Don't promise members that the conversion will provide certain benefits or that invested contributions will generate a specific rate of return, warns vandenHoven. Avoid financial projections, estimates or statements about benefits that are based on investment performance or market conditions you can't control. It's a good idea to add a disclaimer to the conversion notice that DC benefits are based on financial performance and that past performance doesn't guarantee future performance.

Another way to help members understand the financial impact of the conversion is to furnish them tools such as worksheets or software programs enabling them to calculate how much a certain contribution in dollars in a given year is likely to return in retirement benefits under both the DB and DC plan. Of course, you need to ensure that the assumptions on which calculations are based are accurate. And expressly state that these are just estimates and not guarantees.

### **3. Going Heavy on the Jargon**

**Pitfall:** The conversion of a DB to a DC is a concept that members are likely to find difficult to grasp. Consequently, preparing a notice document that only a lawyer could read is likely to result in misunderstandings, uninformed decisions and litigation.

**Solution:** Avoid jargon and define technical terms like "defined benefit," "defined contribution," "actuarial surplus" and "redemption." Try to keep the language as simple as possible, especially when describing the members' options and impact on their benefits. An eighth grade reading level is generally considered the gold standard.

### **4. Placing Too Much Reliance on Acknowledgement Form**

**Pitfall:** Many employers ask members to sign a form acknowledging that they received, read and understood the notice. In fact, some provinces, such as AB, MB and SK, suggest you get members to sign a formal acknowledgement. But a signed notice isn't an ironclad guarantee that notice is proper. Moreover, keeping track of who has and hasn't returned the acknowledgement may create hassles and potential for mistakes that cancel out any advantages you gain by using the notice.

**Solution:** Understand that getting members to sign an acknowledgement is no panacea. Acknowledgements work best when you have employees sign them when they exercise an option in connection with the conversion. The form should specifically acknowledge that the member understood the information before exercising the option.

### **5. Not Getting the Facts Right**

**Pitfall:** Although it seems like an obvious point, plans have gotten into trouble for not checking the accuracy of the statements they made in their notice. Sometimes crucial facts get lost or misstated when plans, in an effort to make the notice more readable, oversimplify things.

**Solution:** Don't release the notice and explanation without taking the time to read it over and ensure that all of the details are clear, accurate and complete. Pay particular attention to the accuracy of statements about members' benefits and the consequences of the conversion. It's more than simple fact-checking. You must make sure that when you've tried to break this complicated subject down for members, you've done so in a way that is not only easy to understand but actually correct.

### **6. Using the Wrong Delivery Method**

**Pitfall:** It's not just what you say in the notice but how you deliver it to affected

members that counts. If you select the wrong delivery method, the notice is invalid.

**Solution:** Make sure you use the delivery method your province requires. Fed, NL and NS are the only pension laws that give direction about how to provide notice specifically of a DB to DC conversion. In NL and NS, notice must be personally delivered or sent by mail (registered for NL, first class for NS) or delivered to the members' last known address. Fed requires that notice be given at the place of employment or mailed to the members' residence.

How should you deliver notice if your plan isn't subject to Fed, NL or NS law? Lawyers recommend delivering notice by multiple methods, even if the law doesn't require it. Hand delivery is the best method—for example, by including the notice in the employees' pay cheques or a special envelope that calls attention to it. Mailing is also advisable as is posting the notice in the break room, lunch room or other conspicuous place in the workplace where employees are likely to see it, and handing it out at a meeting or presentation addressing the conversion. If you email notices, make sure members can print those out so they can show it to their spouses, accountants or financial advisors.

## **7. Not Seeking Outside Help**

**Pitfall:** The question of what to tell members about a DB to DC conversion and how to say it is a complicated issue that requires expertise that many employers and plan administrators lack. So trying to prepare notice on your own is risky and could lead to liability for, among other things, breach of fiduciary duty.

**Solution:** Discuss all the options and details of the conversion, including the impact on members' benefits, with: actuarial advisers—to ensure clear and accurate explanation of what the amendment entails and how it impacts benefits; communication consultants—to ensure that the message to members is as clear, and concise as possible; and lawyers—to ensure that the notice is accurate, comprehensive and in compliance with all pension laws and regulations. You might also want to seek the input of employee representatives on the best method to notify plan members of the conversion.