Using Funds from One Pension Plan to Contribute to Another

Today, many of the old pension plans are being converted from defined benefit (DB) to defined contribution (DC) plans; others are being amalgamated with existing plans. Plan conversions and mergers raise a tricky legal issue: Can the administrator of the resulting plan use surplus funds in one of the plans to carry out its financial obligations to the other? In many cases, the original plan documents fail to directly address this question. After all, the founders of the original plan probably didn't foresee that the plan would be converted. That leaves it up to the courts to decide if "cross-subsidization" is permissible. Here are 2 leading cases illustrating the factors courts rely on to make that determination.

CROSS-SUBSIDIZATION IS OKAY

FACTS

A doughnut company establishes a DB pension plan in 1954. In 2000, it adds a DC component. All new employees must participate in the DC component. Existing DB members get a one-time choice: Stay in the DB or move to the DC. After the conversion, the plan administrator uses surplus money the plan accrued when it was a DB to finance a contributions holiday to the DC component. Members accuse the administrator of irregularities in running the plan and ask the Superintendent of Financial Services to investigate. The Superintendent finds that the administrator had no right to use the plan's DB funds to satisfy its DC obligations. The resulting case drags on through 3 years and 2 appeals.

DECISION

The Ontario Court of Appeal rules that the administrator can use DB funds to meet its DC obligations.

EXPLANATION

The Trust Agreement establishing the original DB plan stated that plan income must be used “for the exclusive benefit of beneficiaries.” Since there were no DC members when the plan was founded, only DB members could be considered beneficiaries. So using DB funds for contributions to DC members violated the Trust. Or, so the members argued. But the court didn’t buy it. Under the Trust agreement, “beneficiaries” are persons “designated under the Plan.” The administrator had in fact designated DC members as Plan beneficiaries after the conversion. More importantly, the court ruled that neither the DB nor the DC members were entitled to plan surpluses while the plan was ongoing. Plan members can’t claim any of the surplus money in the plan unless and until the plan shuts down, it explained.

Nolan v. Ontario (Superintendent of Financial Services), [2007] O.J. No. 2176, June 5, 2007 (This case is also referred to as the “*Kerry Case*”).

CROSS-SUBSIDIZATION IS NOT OKAY

FACTS

After a merger between 2 insurance companies, NN Life takes over administration of the Halifax Life pension plan. The administrator keeps the assets of the Halifax and NN plans separate. But it combines the assets of both plans to calculate its funding obligations. The Halifax part of the plan is in surplus and the NN part is in deficit; but when the assets are combined, the overall plan is in surplus. Based on its calculation, the administrator decides to take a contribution holiday. As a result, the deficit in the NN part of the plan grows significantly. Later, when the plan is sold, the administrator assures the buyer that all contributions have been made and the plan is fully funded. When the buyer finds out about the NN deficit, it sues the administrator.

DECISION

The Ontario Court of Appeal rules that the administrator had no right to include the Halifax assets to calculate its obligations to the NN part of the plan.

EXPLANATION

Unlike in *Kerry*, the plan in this case was not a single entity. The Halifax and NN parts of the plan were actually separate plans. There was never a merger of the two plans, the court explained. Like in the *Kerry* case, the original Halifax Trust agreement banned the use of plan assets for any purpose other than the “exclusive benefit of the beneficiaries.” Participants in the Halifax part of the plan were “beneficiaries;” but participants in the NN part were not. Without amending the Trust agreement, the administrator had to use the assets in the Halifax part of the plan exclusively for the Halifax employees; consequently, the administrator had no right to use the Halifax assets to satisfy its financial obligations to participants in the NN part of the plan.