

## Interpretive Guideline #02 Defined Contribution Provisions

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This guideline is designed to summarize sections of the [Employment Pension Plans Act](#) (the Act) and the [Employment Pension Plans Regulation](#) (the Regulation) as they relate to defined contribution provisions. This guideline summarizes the legislative requirements which apply to the subject matter, and includes (as applicable) additional details to outline the Superintendent of Pensions' (Superintendent) expectations and requirements where such authority has been provided by the Act and Regulation. Finally, the guideline outlines best practices and policies that the Superintendent expects from provincially regulated pension plans.

The Act and Regulation should be used to determine specific legislative requirements. Any legal authority of this Guideline rests in the areas in which the legislation delegates authority to the Superintendent to accept a proposal or action.

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### What is a Defined Contribution Provision

Section 1(1)(p) of the Act defines a defined contribution provision as a provision of a plan text document of a pension plan that:

- (i) Contemplates that an actual or notional account will be maintained to record what is provided by
  - (A) contribution, other than additional voluntary contributions, made by or on behalf of a member, and
  - (B) interest and any other amounts allocated to the account,and
- (ii) provides that the benefits to which the member is entitled under the provision are determined solely by reference to the amount of that account.

### Contribution Formula Requirements

Section 8(1)(e) of the Act requires that a plan text document must provide for benefits and entitlements on

- termination of active membership,
- death,
- pension commencement dates, and
- termination of the plan.

Section 8(1)(i) of the Act requires that a plan text document must contain the method for determining benefits, member and participating employer contributions and the allocation of contributions.

Under section 14(2) of the Regulation, the formula for determining member and employer required contributions must be the same for every member that falls under a class of employment which is eligible for participation in the plan. The minimum employer contribution must be 1 per cent of each member's earnings. It should be noted that this is a more stringent requirement than that required under the [Income Tax Act](#) of 1 per cent of total earnings of all plan members.

## **Funding Requirements and Remittance**

Section 45 of the Act obligates all participating employers to comply with the funding requirements applicable to the plan.

Section 53 of the Act requires that a participating employer must make contributions to a defined contribution provision in accordance with the amounts specified in the plan text document.

Section 56 of the Act and section 68 of the Regulation require that the participating employer remit employer and employee required contributions, as well as additional voluntary contributions made by the member, on a monthly basis. Contributions must be remitted within 30 days of the end of the month to which they relate or were received.

An exception to this provision applies for contributions which relate to the profits of the participating employer. In those instances, contributions must be remitted within 90 days after the end of the fiscal year to which those profits relate.

Contributions must be remitted to:

- in the case of a single employer plan, to the fundholder
- in the case of a collectively bargained multi-employer plan, to the administrator, or
- in the case of a non-collectively bargained multi-employer plan, to the administrator or the fundholder as set out in the plan text document.

If the administrator is not also the fundholder, then after receiving the contributions from the participating employer, the administrator must promptly remit those amounts to the fundholder.

Under section 58 of the Act, contributions which are required to be remitted are deemed to be held in trust for the members until such time as they are remitted.

## **Commuted Value**

Section 1(1)(k)(ii) of the Act defines the commuted value of benefits

under a defined contribution provision as the total amount of the contributions that are or were required to be made in relation to those benefits and includes interest on those contributions.

This is the amount that must be paid when a member terminates membership for any reason. The amount is determined at the end of the month preceding the date of payment.

## **Investment of contributions and interest**

Sections 62 of the Act and 72 of the Regulation set out the rules for the investment of pension plan assets, which includes the requirement that the assets of a plan must be invested, and the investments must be made, in accordance with Schedule III of the federal [Pension Benefits Standards Act](#).

The investment of member DC accounts may be made in accordance to the investment decisions of the employer, by the member, or a combination of the two. In either situation, section 14(8) of the Regulation requires that the plan text document must specify who is responsible for directing the investment of the member's DC account.

### Employer Directed

If the investment of the funds is directed by the employer, then the employer must establish a Statement of Investment Policies and Procedures ("SIPP") that complies with the requirements of section 54 of the Regulation.

### Employee Directed

If the investment of the member's account funds is directed by the plan member, then the administrator must ensure that the investment options are sufficiently varied to allow the member to create a portfolio of investments that is appropriate for retirement savings.

While there is no requirement for a SIPP to be established, the variety of investment options should be discussed with the fund holder or plan's investment advisor when the plan is established, and reviewed on a regular basis to ensure the options are appropriate.

### Default Account

Where members are responsible for making investment decisions, section 72(4) of the Regulation imposes conditions on "default investment accounts". Where a member fails to provide direction regarding the investments, those assets must be directed to either:

- a balanced fund , or
- a portfolio of investments that takes into account a member's age (i.e. a target date fund).

The default account applies to all members of an Alberta registered

plan irrespective of the jurisdiction where they are employed. The Alberta default account does not apply to member employed in Alberta where the plan is registered in a jurisdiction other than Alberta.

## **Optional Provisions**    Lump Sum Payments

For active members who are within 10 years of the plan's pension eligibility date, and whose working time and remuneration have been reduced in agreement with a participating employer, section 94 of the Act permits the payment of a lump sum amount to compensate for the reduction in salary.

Section 88 of the Regulation sets the criteria for the lump sum payments, and establishes a maximum amount of the lump sum, which is to be no greater than the smallest of the following amounts:

- 70 per cent of the reduction in the active member's pay as a result of the reduction in his or her working time during that year,
- 40 per cent of the Year's Maximum Pensionable Earnings (YMPE) for the fiscal year,
- if the agreement for reduction in working hours will not cover the full fiscal year, 40 per cent of the YMPE for that year prorated to reflect the portion of that year that is covered by the agreement, and
- the commuted value of what would have been the active member's benefits if he or she had ceased to be an active member on the date of his or her application for payment of the lump sum.

While receiving lump sum payments, the active member continues to earn benefits under the plan.

## Life Income Type Benefits(LITB)

Section 78 of the Regulation permits a pension plan with a defined contribution provision to set up, within the plan fund, a decumulation account for retiring members called a Life Income Type Benefit (LITB) Account. The account would run similar to a Life Income Fund (LIF) provided by a financial institution.

The establishment of an LITB account requires the completion of a pension partner waiver [Form 8](#), however (unlike in the case of a LIF, the retiring member is not permitted to apply for financial hardship unlocking from the LITB account.

The calculation of minimum and maximum withdrawal amounts are the same as a LIF.

### Forced Transfer on Termination of Active Membership

Under section 100 of the Act, in the case of a benefit entitlement which arises out of a defined contribution provision, the plan text document of the pension plan may provide that on a member's termination of active membership, the member or the surviving pension partner is required to elect a portability option.

The ability to force the transfer of the whole of the benefit entitlement to which the member, or surviving pension partner, is entitled to applies:

- to a member who terminates (or, in the case of a surviving pension partner, to a member who dies) on or after September 1, 2014, and
- that member's entire entitlement to a benefit arose under a defined contribution provision.

If the benefit is less than the small amounts commutation limit in any given year and the member has not made an election and the plan text so provides, the administrator may pay out the member's benefit entitlement less with-holding tax to the member's last known address.

### Auto-Annuitization

While not a specific provision within the new Act and Regulation, the Superintendent's office has had discussions with industry around auto-annuitization as a potential decumulation strategy for benefits earned under a defined contribution provision.

For the purposes of this Interpretive Guideline, there are two options in which to consider auto-annuitization.

#### **Option 1 – Incremental purchase of a deferred life annuity on an annual basis with the member's year-end DC account balance**

Under this option, while a member is an active member of the pension plan, a deferred annuity would be purchased on an annual (or some other incremental) basis. The amount of annual income provided by the deferred annuity would depend on the annuity purchase price, and the amount of money held in the member account, at the time of annuity purchase.

The member benefits from transferring away longevity risk through the purchase of the annuity, and as well, potentially avoids the annuity pricing risk (i.e., purchasing an annuity in an unfavorable interest rate environment), which is commonly cited as a problem with the current

“all or nothing” approach of existing annuity purchases.

The Superintendent will permit this option, subject to the following conditions:

- The plan text document, and all communication materials which are provided to plan members, must clearly detail the auto-annuitization feature.
  
- The form of the life annuity:
  - will not start earlier than the date that is within 10 years of the plan’s pension eligibility date,
  - will start on or before the last date on which a person is allowed under the [Income Tax Act](#) (Canada) to start receiving a pension,
  - there is no differentiation among the annuitants on the basis of gender, and
  - if, on the date of pension commencement, the member has a pension partner:
    - the life annuity is in the form of a joint and survivor pension as described in section 90(2) of the Act (i.e. a 60 per cent joint and survivor annuity), or
    - if a different form of annuity is selected by the member, a waiver in [Form 4](#) has been signed by the pension partner and provided to the administrator not more than 90 days before the pension commencement date.
  
- Where the member terminates active membership prior to his or her pension commencement date, the member is still entitled to portability options in accordance with section 99 of the Act.

This means that there must be a mechanism which would allow for individualized deferred annuities, which had previously been purchased for the plan member, to be converted back into a lump sum amount which reflects a current market value.

**Option 2 - Automatic life annuity purchase on termination of active membership, if the member, on date of termination, is within 10 years of the plan’s pension eligibility age**

Under this option, a deferred or immediate life annuity would be purchased on behalf of a member who has terminated active membership. The amount of annual income provided by the annuity would depend on the annuity purchase price, and the amount of money held in the member account, at the time of annuity purchase.

Legislative authority for this type of annuity purchase would fall under section 8(1)(f) of the Act, which requires that a plan text document must provide a deadline for selecting a (termination) option, and the consequences of not meeting that deadline.

The Superintendent will permit this option, subject to the following conditions:

- The plan text document, and all communication materials which are provided to plan members, must clearly detail the auto-annuitization feature,
- The annuity which is purchased must be that which is described in Option A, and
- The annuity may only be purchased after a termination option statement has been issued to the member, and in accordance with section 92 of the Regulation, at least 90 days has passed since the member received the termination option statement.

## Disclosure

Section 37 of the Act requires that members, surviving pension partners, former pension partners, and designated beneficiaries are entitled to information as outlined in the Regulation.

Sections 30 to 46 of the Regulation provide details of what must be disclosed in the various statements and information provided to the required individuals.

<b>For further information please contact:</b>	
Superintendent of Pensions Alberta Treasury Board and Finance Room 402, 9515 - 107 Street Edmonton, AB T5K 2C3	Telephone: (780) 427-8322 Fax: (780) 422-4283 Email: <a href="mailto:Employment.Pensions@gov.ab.ca">Employment.Pensions@gov.ab.ca</a> Internet: <a href="http://finance.alberta.ca/business/pensions">http://finance.alberta.ca/business/pensions</a>
For toll-free dialling within Alberta, call 310-0000 and then dial 780-427-8322.	Sign up for electronic notifications: <a href="http://finance.alberta.ca/subscribe/epen">http://finance.alberta.ca/subscribe/epen</a>