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EMPLOYEE BENEFIT ASPECTS OF MERGERS/ACQUISITIONS/SPIN-OFFS

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(1) Pension Benefit Liability.

(2) Other Employee Benefit Liability.

(3) Other Executive Compensation Plan Liability.

(4) Multi-Employer Pension Plan Amendment Requirements.

MR. GORDON B. LANG: In the case of Other Employee Benefit Liability, specific concerns relate to:

(1) Date of assumption of liability for the Other Benefits by the New Employer, usually the Closing Date of Sale.

(2) Payment in full by the prior employer of all required Employer and Employee Contributions up to the Closing Date.

(3) Ownership of any Group Benefit Surpluses, and date of their calculation and by whom, a Consultant or Insurer?

(4) Responsibility of any Deficits at the Closing Date, their calculation, by whom and the means by which these deficits will be funded.

(5) Coverage after the Closing Date, non-medical and coverage limits, possible changes in Insurers, notification of new arrangement to employees.

For Other Executive Compensation Plan Liability, which may include "Golden Parachutes", Special Early Retirement Arrangements, Non-Funded Supplemental Pension Arrangements, Deferred Compensation Arrangements, Special Benefit Arrangements and Deferred Bonus Arrangements all of which relate solely to the executive group, the considerations fall into the following areas:

(1) Responsibility for funding these arrangements up to the Closing Date.

(2) Whether the Merger/Sale/Spin-Off will have the effect of triggering off any special benefits and if so, who is responsible for their funding.

(3) Whether the Merger/Sale/Spin-Off will result in a requirement to fund or partially fund any benefit that was previously unfunded, and by whom.

(4) Whether there is any requirement for the new entity to continue such benefits after the Closing Date.

For Multi-Employer Pension Plan Amendment requirements, specific concerns relate to:

(1) Whether the Merger/Sale/Spin-Off will require the new entity to withdraw from the Multi-Employer Plan after the Closing Date.

(2) Whether an actuarial valuation of all or part of the entire Plan will be required in order to spin-off the new entity.

(3) Whether the liabilities and associated assets for service up to the Closing Date will require to be withdrawn and transferred to the new Employers' arrangements.

(4) Drawing up and suitably registering the new entity's Plans with the appropriate authorities.

MR. H. DOUGLAS LEE: Employee Benefit Plans that could have unfunded obligations are:

Employee Pension Plans - As an actuary, the role to be fulfilled is that you are acting on behalf of the client and you're trying to assist that client in identifying unfunded liabilities, typically when you are representing the buyer; but, presumably you might even be advising the seller. Amazingly enough, many Vice-Presidents, Finance or C.E.O.'s really aren't aware of the pending liabilities that they have.

Special Executive Pension Plan - The special executive pension plan is so secret that probably the only individual that is aware of it in Canada might be the Vice-President, Finance because he gets in on all these perqs.

Supplemental Gratuitous Pensions - Occasionally, I have found that there are certain gratuitous pensions, or hidden employee benefit plan that is or is not funded to provide for that. These pensions may be paid out of earnings or there may be some hidden employee benefit plan that is or is not funded to provide for these payments.

Deferred Compensation Arrangements - These may be discovered or identified either by the existence of no fund at all or some sort of employee benefit trust.

Typically, within the sale/purchase agreement, is some innocuous little phrase talking about maintaining in-force the current employee benefit programs for the employees. Providing both sides are lacking in knowledge of employee benefit plans, then this arrangement is quite satisfactory. However, if either party has any knowledge about employee benefit plans, this particular wording is a disaster. As a consulting actuary, you can count on one or two years of very stiff negotiating if there is any money involved.

MR. LANG: Due to the fact that we have had some pretty good financial markets in recent years, we can have the opposite problem of unfunded liabilities. I find my current experience with sales, divestitures, etc. is concerned with who owns the surplus rather than who is responsible for an unfunded liability. It puts a rather interesting, slightly different slant on things.

Coming back to the point you are mentioning, I find this only in the case of a few significant clients who have a lot of experience in purchasing and selling companies, divisions, etc.. They would contact me prior to the advanced stages of negotiations just prior to the final drafting of the documents. It seems to be rather difficult (until it costs them a lot of money) to convince them that the actuary or the pension consultant should be involved right at the very beginning. Through time we're going to see that in a lot of situations (I've come across a couple pretty close to it) where the value of the surplus or unfunded liability in the pension plans is greater than the value of the company. One can only look ahead 20 or 30 years from now when pension plans are more mature than they are today that more and more we're going to see situations where the main asset or the main liability is with respect to the pension plan. By that point in time, I'm sure we will be more involved. One difficulty I have with large companies (10,000 employees) is with people spread throughout the company involved in their own divisions in buying and selling assets. It is often too late by the time we're called upon to get the wording in the agreement appropriate in order to facilitate the final handling of the pension plan unfunded liabilities, assets and surpluses.

MR. LEE: SALE/PURCHASE AGREEMENT - The necessary Steps regarding Pension Plans are:

<u>Identify and Define Pension Plans</u> - This is normally fairly straightforward, but can be tricky, with a single employer plan, in making certain that the buyer (client) understands what his obligation is in a bilateral or negotiated arrangement. Sometimes they forget the fact that they are going to be assuming an identical plan. With respect to multi- employer and joint trust agreements, these are very different situations and each one is normally a special problem.

Identify and Define Affected Members - Broad categories are: active, inactive, suspended and pensioners. Frequently there is a very different approach and treatment in each of these categories. Certainly with respect to the active, one normally finds that if there is any group of employees in which there is going to be a transfer of assets, it is this particular group. Frequently the buyer is prepared to carry on the pension plan and the seller is normally quite prepared to transfer assets or liabilities with respect to the active employees, be they vested, non-vested, or eligible for retirement. I point this out because the eligible for early retirement may be an exception in a sale or divestiture. Frequently those who are eligible for retirement decide that they really have had enough - they are a little concerned about the new employer and they may well decide to check out (particularly if the seller decides to sweeten up the early retirement provisons) with the inactive, suspended, and pensioners. With respect to my experience, if there is any group of employees for which assets are not transferred, it is frequently the inactive, suspended and pensioners (particularly the pensioners and in-active). Usually the seller may decide to go out and purchase these particular benefits. The suspended are very seldom identified - you don't know what is out there. If you have had an opportunity to become involved before the actual sale and you've got a good lead time, you may in fact try to identify who is on long term disability and what, if any, are their liabilities (similarly with respect to lay-offs).

MR. BRUCE J. MacDONALD: I have one comment on the pensioners from a spin-off I've been engaged in. One reason we kept the pensioners is that the employer has been in a habit of giving ad hoc increases to the pensioners and he says these are our people and his new purchaser is not going to be interested in these people one little bit - they've never worked for him, he doesn't know them. It is our moral obligation to hang onto them and do what we do for our remaining pensioners.

MR. LEE: I think it would be very untypical for the buyer to feel any obligation to these people. You presumably kept the assets on the valuation basis that you had been using?

MR. MacDONALD: Yes.

MR. LEE: Definition of Accrued Benefits - If you have a couple of lawyers involved in the purchase/sale agreement and you haven't had an actuary up to now, they will probably say something about the fact that assets sufficient to cover the accrued benefits shall be transferred and any surplus remaining will be left to the glory and luxury of the seller. I don't have a lot of difficulty in defining the accrued benefit for flat dollar plans, as long as it is a pretty simple straightforward arrangement - like no subsidy on early retirement; and the fact that the buyer understands that if the union is ever successful in negotiating a benefit increase, they will likely negotiate the benefit increase in respect of service with the seller. I never know what assumption to make with respect to incidence of retirement when I am determining this. I find that if I happen to be representing the buyer, I think that everybody will go out and retire early, even at age 55. On the other hand, if I'm representing the seller, they are all going to love this new employer and they'll probably want to stay on right up until the last moment: therein lies the problem. With respect to career average plans, as far as the definition of accrued benefit is concerned, one has to assess what is the probability of, and what is the responsibility for future pension updates. You may not even have a choice. It may well be that somewhere down the line there will be some kind of mandatory indexation of benefits. Hopefully, we are assured that it won't be applicable to past service. If the wave were to ever develop, it is possible that one could in fact have updates with respect to the past and you may wish to transfer sufficient assets to provide at least part of this update.

MR. LANG: Often in a career average plan, you'll have a specific clause in the plan text which states that any surplus or surpluses that are generated must be employed to improve the benefits of the members. In which case, we don't really have a problem if the plan is continued. I would assume that the plan would be transferred intact to the new employer.

MR. LEE: Question: So the entire assets would be transferred?

MR. LANG: That's right. This is an important point, because in terms of ownership of surpluses in particular, as I mentioned earlier, it has become a much more common situation to have a surplus rather than an unfunded liability today (especially in Canada) in these situations. The ownership of the surplus or the ability of the trustees to handle the surplus is important. For example, the plan text may say that the surplus after providing in full for all obligations of the plan is the property of the employer. That tends to be the situation in most plans, but I've seen others where it specifically states that the surplus is the property of the employees. We also have a very interesting situation (if you have members in Manitoba) where the Manitoba legislators are saying that all surpluses are the property of the employees.

MS. KAREN KRIST: I think one of the important things that we need to point out to the purchaser - one of the most important pieces of information that the actuary can tell the purchaser - is if you've got the kind of provision you're talking about here and if the purchaser has set his purchase price on the basis of the income statement of the company he's acquiring and if you transfer only the assets for the accrued benefits and leave the surplus, then the pension accruals in the company which he has bought will increase perhaps substantially because he's left the surplus behind. What seems like a perfectly fair and reasonable basis for transferring assets just to cover accrued benefits, in fact, is going to have a very definite effect on the income statement and that's probably where he based his purchase price. That is probably the most useful single piece of information because the lawyers have figured this out but they haven't made the second connection frequently.

MR. JOHN MAYNARD: On the same point of career average, it might happen sometimes that any updates that would have been given under the old plan, might not be given under the new one. It seems rather important to identify that because from the employee's point of view, he's not responsible for the acquisition, etc. and just because that happens if the plan is not carried out the way it has been, of course he's obviously going to be disappointed. Your drawing attention to this is important. Are there any guidelines on how this works out? They kind of work out sometimes one way and sometimes another.

MR. LEE: My experience has been that there are precious few cases where surplus is in fact transferred. I would see on a career average plan, typically what happens is sufficient assets are transferred to cover the accrued benefit and probably on a realistic basis rather than the valuation basis. So there would be little, if any, provision for updates as far as the transfer is concerned. What may happen is that there is no transfer of any assets with respect to the accrued benefit - depending upon the opinion or view or obligation of the seller. He may well say: "I will, in fact, be responsible for the benefits accrued up to the effective date of sale and you, the buyer, will take on that responsibility after." Therefore, there isn't any transfer of assets and the buyer, when confronted with the employees who say: "How about updates for the past", says "I have no assets, I have no liabilities, and I have no responsibilities. That is the problem of the predecessor". That is something that goes back to the responsibility of the seller and he walks away from it. Whether he should or not is possibly the controversial issue. You get the same situation with respect to final average plans. Clearly, there is a greater responsibility there, presumably, to transfer assets to cover something with respect to future salary increases and that is the plan that is in existence. The dilemma I found is that, with respect to seller, he may transfer sufficient assets to cover future salary increases, that may well provide 75% more assets than what is required to cover the accrued benefits. We all know that the buyer may well decide in one month, one year (whatever) to change the plan dramatically. He may well decide that final average plans are not his bailiwick and he really wants to go to a defined contribution plan. What is the assurance to the seller who has transferred all these assets that they will in fact be used to provide benefits for the employees? I ran into a situation about a month ago where in fact they wanted to transfer sufficient assets to provide for future updates and the buyer got rather concerned because he said: "I really will have to continue this". We talked about putting wording in the purchase/sale agreement and the thing that was causing some concern was the impact of the Revenue Canada limits. He said: "if I do decide to fold this thing up and even if I want to give these employees all this money, unfortunately I won't be able to do so because Revenue Canada will come down". (For those in the U.S., it is a maximum imposed on the benefits based upon accrued service and salary). The only assurance that we could arrive at was that to the extent that there were more assets than required, we would in fact just pay those excess assets out to the employees assuming we could get the money out of the plan. Unfortunately, you might not be able to get the assets out of the plan because of provincial restrictions.

The best kind of plan that I like to negotiate on is a defined contribution plan. It is simple and you don't have to worry about any definition of accrued benefits; it's neat clean-cut; and no concern exists about mandatory indexation. Not many employers are looking at defined contribution plans - possibly because their actuaries haven't gotten around to telling them that it is very worthwhile. In Canada I think if the Liberal budget of February 15th were to go through unadjusted, you might find considerably more employers looking at defined contribution plans.

I've already talked about some of the points that I think one might look at with respect to defining the accrued benefits - I mentioned the early retirement subsidies. Clearly, bridge benefits are very difficult. It is in the same category as early retirement subsidies - how do you in fact define the value of the bridge benefit and put that into the cost of the accrued benefit. Vested and non-vested accrued benefits, in my experience, pose no problem. Invariably, the seller will transfer sufficient assets to cover both vested as well as non-vested accrued benefits. The maintenance of some sort of record as to when an existing active employee becomes vested later on under the seller's employment, isn't worth the effort. There normally is not that much money involved.

Mandatory indexation is clearly a consideration. My experience is that employers are more inclined to purchase benefits because they believe it will somehow save them from some future mandatory indexation. If the benefit is purchased and salted away with an insurance company who is unlikely ever to be forced into providing madatory indexation, then they are somehow protected.

MS. KRIST: We've seen, not unusually, in plans that are anything other than the simplest that the entire (we're assuming here in all these cases that you've got a big plan that you're trying to split something off as opposed to one that you're just carrying over) assets that are available will be split according to the accrued liabilities for the leaving group and the staying group. That automatically takes care of not only the problem that I talked about before, but some of these other things where it's really hard to get a handle on what the accrued liabilities are. In the United States, there is an additional problem. There do not seem to be any rules about who gets the credit balance in the funding standard account when you split out some employees from a plan. Although the credit balance is something of a fiction, in that it is not a real asset, it does affect the timing. If you get to keep the credit balance, you have a lot more leeway in what you're going to do than if you send some of it over or if you only get a piece of it. Since that's an area that only actuaries pay attention to, actuaries can argue about it forever. There don't seem to be any rules, or at least the last time I checked with the IRS they said to do anything reasonable.

MR. DAVID MARTIN: In an insurance company, you get involved in these sort of things more by accident than by design because your field representatives don't know when to say no. We were involved with one recently and I was interested in the comment concerning vested and non-vested. The seller and the consultant for the seller felt there was no obligation to transfer assets with respect to non-vested benefits. Is that common/uncommon as you've suggested? I felt it was rather strange that they felt no obligation to transfer any assets for the non-vested employees.

MR. LANG: I presume at the same time, they weren't forcing the acquiring employer to provide for benefits for past service - that they were allowing that employer to start it from scratch. It has been my experience that there is a certain amount of give or take in the negotiations - you can't have it all your own way.

MR. LEE: When we talk about carving out or a spin-off divestiture, my experience is that frequently the assets are not transferred. The seller merely assumes responsibility to provide the accrued benefits. If there is a transfer of assets, and I was acting on behalf of the seller, I would be negotiating very hard to identify the surplus that is in the transfer of assets and have that reflected in the purchase price. Thus, one may solve the problem in the sense that the assets are actually transferred in some sort of proportion to liabilities, but it doesn't solve the negotiating problem. You still have to have some kind of agreement as to what is in fact the surplus that is inherent in the transfer.

Special Plan Provisions - Occasionally, you read a pension plan that actually anticipates sale in it and they may have very special provisions and obviously one has to check that out if you are advising the employer.

Establish or Define the Accrued Benefits - We have the fund and we can now try and determine what is the liability associated with our definition of accrued benefits. My guess is that one could in fact put ten actuaries in a room and probably get ten bases, but I've tried to classify on three essentially ongoing or valuation bases. You might say that is how we should determine the liability for the accrued benefits, then moving on, you might say well no one would ever require anybody to use 7%. No one would begin to believe that that is a realistic basis. We all know in this day and age that one can earn 11% or 12% with relatively great ease, so maybe somebody argues for a much more aggressive realistic basis. You may encounter an enlightened actuary who says on the other side "well what we should do is do it on a wind up basis because we all know that the buyer has the opportunity to wind this operation up in six months or whatever; assuming it is a unilateral or non-negotiated arrangement".

It would be interesting to review the following information:

Liabilities (000,000's omitted)

	Pensioners	Actives	Total
Ongoing	4.8	3.0	7.8
Realistic	3.3	1.2	4.5
Wind-Up	3.3	2.2	5.5

As you would expect on the ongoing basis, there is a $7.8 million liability; $4.8 million for Pensioners; $3.0 million for Actives. Realistic is no surprise to anyone. We just moved from 7% to 9% and we see that our liabilities for pensioners has come down rather dramatically but not merely as dramatically as what it did for actives. Again, quite anticipated. The wind-up shows little change from realistic for Pensioners; however, it increases by $1 million under actives. That relates, of course, to Bill 214 (Ontario situation) that came out in December, 1980 under the Ontario Pension Benefits Act and it states that under a wind-up basis, anybody age 45 and 10, if they will at some point in the future qualify for subsidy on early retirement, then you must provide for that subsidy on early retirement assuming that they elect to retire early". So you go around to all the employees and say: "Do you really want this subsidy?" Most of them, within the three month time limit will say yes. Therefore, the liability soars up (as a matter of fact, it gets very close to the ongoing). I've seen a situation where this, in fact, exceeded the ongoing arrangement because the utilization on early retirement was assumed to be relatively low and when you increase to 100%, the increase in the liability as a result of 100% utilization, more than offsets any reduction in liability as a result of using a more realistic interest assumption. Presumably if you are operating in any other province, you wouldn't have this problem. Is this correct Mr. Maynard?

MR. MAYNARD: You are correct on the Ontario Act requiring these extra options to be available. I can't tell you about the other Provinces. The differences in these figures (above table) are rather striking. Is the difference.between the ongoing and realistic mainly due to the ongoing plan being required to provide for salary increases, updatings, and improvements; whereas with realistic or wind-up, it is not so? Is that the main reason for the difference between the three lines?

MR. LEE: I think in part, but the other very significant impact was increasing the interest rates significantly.

MR. MAYNARD: What I am getting to is an idea I've had - that actuarial evaluations are not the most understandable kind of financial statement and yet extracts of them are required to be released under the disclosure arrangements (certainly in Ontario). People are becoming more and more interested in what is in the plan and what the financial condition of it is. I hope that we can make the statement more understandable so that they don't jump from one of these positions to the other. One way of doing this would be if, on the ongoing plan, you separated out something and showed what is required to keep the benefits moving if it is ongoing; then if it stops being an ongoing plan and becomes a wind-up type of situation, then obviously you don't need that.

MR. IAN MALCOLM: The problem with that is that clients wouldn't want to pay the actuary's fees in doing both bases. The second point is that the other difference between realistic and wind-up here, or ongoing and wind-up, is that your wind-up doesn't have termination probabilities. That is probably going to be a very big difference.

MR. NICK PHILLIPS: I'm not too sure that the same wind-up problem exists in the U.S. because of the new Pension Equity Act. You can't take away anything they have and I'm not really sure that it affects someone who is ineligible for early retirement who is age 45 and 10 years of service if in the future this benefit can be taken away if the buyer maintains the pension plan. In fact the realistic assumption is maybe 2.2.

MR. LEE: There is a similar legal view in Canada that states that if the individual has earned a benefit or is entitled to a benefit, clearly you can't take it away from them. The question then boils down to if the arrangement is that after attaining age 60 and having 30 years of service, you're entitled to an unreduced benefit, then at age 59 with 29 years of service, you're one year away. The employer may change the early retirement provision so that it is now 35 years of service at age 60. The argument is you aren't entitled to that benefit until in fact you have satisfied the conditions of that benefit. The thinking behind the Bill 214 of the Ontario Pension Benefits Act was that the clock keeps ticking in a wind-up situation if the employee so elects.

MR. LANG: I've had some experience of valuing both on a realistic and ongoing basis in situations where there is a purchase/sale situation but for various reasons, we've never actually completed the transaction on a realistic basis. It was my understanding, if we were going to however, that looking at your figures, assuming that there were adequate assets to cover the liabilities at date of sale (i.e. $7.8 million and all liabilities will be transferred to the new employer) - on a realistic basis, only $4.5 million would be transferred over. This being the case, I would assume the difference of $3.3 million would be an adjustment in the purchase price. Then comes the point - what effective rate of tax would you tend to use in adjusting the purchase price?

MR. LEE: I think if you've got an agreement on the realistic basis, what would happen is there would be no transfer of assets or liabilities. What would typically happen here is some kind of purchase for accrued benefits and you may well do something different for pensioners versus actives. You may purchase all pensioners and all non-actives, etc. and arrive at some kind of middle ground on the difference between the $3 million and $1.2 million for actives. I have never been involved in a divestiture or acquisition where you would have this kind of dramatic adjustment in the purchase price. I just haven't seen it - maybe someone else has.

MR. MacDONALD: I haven't seen it - but I almost saw it about a year ago. I was involved in a hot-and-heavy session of one company trying to sell somebody to one of my clients (it seems that the basis you agree upon ultimately depends upon whether the purchaser is more anxious to buy or the seller to sell). The realistic basis, of course, is usually on a basis that no pension commission will accept, so if you agree to a transfer of assets on that basis, you immediately have an unfunded liability which probably would end up being an experience efficiency which you would have to fund over five years. You obviously don't do that. At this point the seller decides that he's going to go off and buy benefits from an insurance company so the purchaser doesn't have any unfunded liability. In this particular case, everbody we were getting was unionized and we knew there was no more hope of telling the union that improvements would only be limited to the date of sale then pursuading the union to voluntarily decertify themselves. This was one of the many reasons the sale fell through.

MR. LANG: Coming back to your point Bruce, it is my interpretation (of certainly the Ontario Act) that as a result of the sale of an operation and transfer of pension liabilities, the Pension Commission would not permit the client to be less funded following date of sale and prior to that - certainly not in a situation where an unfunded liability could be created. That was my point that I would look at any adjustment being out with the pension plan assets.

MR. MAYNARD: You're quite right on that. The Pension Commission is quite sensitive to this because we have a pension benefits guarantee fund here in Ontario. If a plan goes from a position of having no unfunded liability to one with one, then the potential liability on that fund comes in and so that is thought of by the Pension Commission in looking at this arrangement.

MR. MacDONALD: I might say the case I'm talking about was an upper Canadian corporation. However, the employees were all outside Ontario, so we weren't going to have Mr. Maynard protecting them. What amused me during the negotiations was that my client, whom I've generally considered as being slightly to the right of Genghis Khan, turned to the seller and said: "if it wasn't for people like you, we wouldn't need all these pension regulatory authorities to protect the employees".

MR. MALCOLM: If Ontario insists then that the first plan be at least the same level of funding, then presumably in an unfunded situation, one always has to multiply by the funded ratio. In other words, you can never transfer assets across in an unfunded plan which are equal to the liabilities?

MR. MAYNARD: I don't know if I can answer that question except to say that the Pension Commission is seeking to have arranged that the unfunded liability doesn't increase because of the acquisition. They don't see any reason why it should increase just because there is an acquisition or merger and that's what they're watching for.

MR. LEE: Presumably what you have here is really the unfunded liability changing, not only with respect to the employees that have been involved in the sale but the existing employees. If you decide to improve the funded status for the employees involved in the sale and you don't put in any more money, then obviously the unfunded liability for the employees that have not been sold increases. I had a situation like that where it turned out that they wanted to ensure that there was no unfunded liability with respect to the employees that were being carved out or spun-off. The plan prior to the spin-off did in fact have an unfunded liability so, because of this problem, the seller had to make a significant contribution so that the unfunded status of the employees remaining with him did not deteriorate. He did it by transferring surplus from another plan.

MR. LEE: Determine Funded Status - You may have a deficit or surplus and it clearly depends on what the basis is (ongoing, realistic, or wind-up). In addition thereto, we now get into a point that I briefly touched on and that is that you may have a significant difference in who's assuming assets and liabilities for accrued benefits, depending upon whether it's active, inactive, suspended, or pensioner. To go back to Bruce's point - possibly with respect to the case you outlined - the seller kept all the assets with respect to the pensioner because he did see an obligation at some point in time to provide for benefit improvements. The break normally occurs between active and all the others.

Still looking at the variation by funded status, if there is ever a balance where assets and liabilities are almost the same with respect to the accrued benefits, it is not a big problem. There have been situations where, although it was never actually stated, I had a deep suspicion that the company was being sold in order for the seller to get his hands on the surplus.

The right to surplus comes under 'what has the plan said' and if there is anything that's worth remembering at this session, it is in fact that point. If the plan is silent on this point, the Provincial Legislation will assume on plan wind-up (you may get into a wind-up situation on a sale) that any surplus belongs to the employee. You must clearly provide for and define the ownership of the surplus. Ownership of surplus also seems to be influenced by the trust agreement occasionally. The trust company has the audacity to put in a provision, well along towards the end of the agreement, and which makes a statement to the effect that the assets shall be used solely for the benefit of the employees and their beneficiaries. This seems to have a rather dramatic effect - it suddenly overrides the plan. I think the corporate trustee has gone a little beyond his responsibilities and I've witnessed situations where it was a standard provision with some of the major trust companies in Canada that they would use this wording unless you specifically had them take it out.

If you are going to transfer assets and there is a commitment of the buyer for future benefits, then clearly you must determine a means to circumscribe or constrain the buyer's right to amend the plan. Most buyers start to get very nervous about this. Although they may well decide that it is not a problem because they have no choice with respect to negotiated agreements, they must in fact continue that to the end of the agreement. You may well have variation, depending upon the assets that are being transferred to a new plan or into the buyer's existing plan.

The last point is 'what is the assessment of future pension costs'. Looking at what has gone on in the past may not be an adequate indication of what will go on in the future. It may be too high or too low, depending upon the basis and funded status. It isn't hard to see in the last few years where the employer may well be putting in zero as a pension contribution. This is probably not a good indicator of what his future costs will be.

I have never seen a transfer other than at market. I've never seen anyone who contended that one should use assets other than at market value. I've wondered if anybody would ever suggest that one should use "the actuarial value of assets". After all, we are determining the liabilities on the actuarial basis, but nobody ever got around to suggesting this. Has anybody had experience where somebody suggested that they would use other than market or book?

MR. MALCOLM: I've never seen it but I could imagine that if the actuary of the purchaser always uses an actuarial value and if the market value is more or less, then the actuary for the purchaser could argue that the actuarial value should be transferred across to protect the purchaser from an unfunded liability. I've never seen that.

MR. LEE: I've never seen it either - I guess if I were the purchaser's actuary, I'd be inclined to change my asset valuation basis if it turned out that the I wasn't getting the value I wanted.

How are Assets Transferred - This is rather a simple matter - I've seen transfers in both cash and the paper itself. It is usually not a big thing other than to define how it is going to be done and when it is going to be done.

MR. LANG: There is one related point to that slate. Quite often there can be a substantial time delay between the date of sale and the date of finalization of the arrangements. Generally, it isn't the fault of the actuary, but there are just so many other things that have to be done. The rate of interest applicable to the cash being transferred can be quite significant if there is a two or three year delay involved. I find from experience that lawyers spend as much time negotiating the rate of interest as they do the balance of the transaction.

MR. LEE: Interest Credit on the Asset Transfer - There are a variety of ways of doing this. To keep it simple (for the benefit of both the actuaries as well as the lawyers), one invariably says the assets shall, from the date of sale, earn a rate of interest equal to what would have been earned under, say 90 day Treasury Bills. This essentially reflects short term interests so that there is a capital guarantee and there is a clearly defined basis on which to transfer assets. You really don't care what the fund is invested in at the time and if it turns out that cash is going to be transferred, then the seller had better get his securities into short term vehicles or he will suffer either asset loss or gain on it. You do need Government approval - whether they be Provincial and/or Federal You certainly need the Federal if there is a transfer of assets. Clearly there are plan amendments invariably involved so you certainly want to cover yourself there. The one thing that is normally badly done is the employee communication. It usually is non-existent and it is surprising that something that is so important is frequently overlooked. We have found that it is of value to discuss these arrangements with the unions - especially if you happen to be the buyer. You do this in order to have some assurance that these matters have been discussed with the unions, that they are aware of what's going to happen, and that if there are any problems, they are going to surface immediately as opposed to six months after the sale has been concluded. After you do all this, you must prepare and file reports. It is worthwhile (especially with respect to Provincial Legislation) to approach the Provincial Regulators to ensure that what you're proposing to do will in fact be acceptable before you get a long way down the path. Obtain their approval in principle and then later on submit the detailed termination reports.

MR. KIT MOORE: I've noticed in the last few years the direct relationship between the level of T Bill rates or short term rates and the speed with which an asset transfer is made. A couple of years ago when the rates were very high, the asset transfer was relatively quick. I'm still waiting for one from the end of March of 1983 because the rate of interest credited to the funds was based on short term rates which have been quite low compared with fund returns over the last year and a half.

MR. LEE: The last item that I'd like to discuss, with respect to pensions, relates to the fact that the issues must be analyzed and identified early in the negotiations - not late. Frequently, what I've done with clients is determine what we believe to be acceptable courses of action and develop financial analyses associated for each one. If you suddenly make a major change in your negotiations, frequently you don't have a lot of time to go back and start from square one. I think having experienced professional advice is worthwhile. Although I have great admiration and respect to St. John's Ambulance people, I really wouldn't want them to perform brain surgery in the middle of a football field for me. The very last item is very specific wording in the purchase agreement relating to the pension and other benefit plans.

MR. MAYNARD: Just before leaving the pension arrangements, I wonder if one additional comment might not be made. I was very impressed with the discussion which seemed to emphasize the importance of a good discussion, agreement, and implementation in the price of the purchase arrangement. The fact that this is not always done seemed to me to be practically a disaster. I wondered what might be done about this. A general thought comes into my mind. If, through the Canadian Institute of Actuaries for instance, a group of actuaries drew up a memorandum stating that in these situations it's essential actuarial practice that a discussion covering these points be undertaken and agreement reached is then put into the purchase agreement. Then perhaps sound a note of warning with the other professions who are inevitably involved in working out of the scheme (perhaps with the accountants) to ensure that a discussion does take place. It seems to me that the importance of the matter that you brought up this morning would justify some steps along these lines. As far as the Pension Commission is concerned (I think I speak for them), they would feel very comforted if the actuaries representing the purchaser and the seller had met and taken part in a discussion of this kind before the purchase was put into effect.

MR. LANG: One point I thought I would add to your remarks Mr. Maynard is that I often end up acting as a conscience of my clients in these transactions and slow them down to point out the overall effect and implications on the individuals of different courses of action. I think as a profession, it is important that we not only represent our clients, but also act as a conscience of the employer. What ultimately the employer does is the employer's business; however, I think it is up to us as responsible professionals not to just look for the financial interests of the employer but also the overall transaction and how it will affect other parties as well as the individuals involved. What we're dealing with in these situations is, for a lot of the individuals involved, their largest single asset. It can be severely impaired by, for example, taking a final average pension plan, having the vendor go into the marketplace, purchase annuities based on salary history to date of sale and then having the new employer do something else, as distinct from the continuation of a final average plan through the sale date into the future. I do not feel that we would be responsible professionals if we didn't point out the disasterous effects on certain long service individuals of taking the easy cheap route every time.

MR. LEE: To address one point that Mr. Maynard made there with respect to these arrangements, I think you, the Pension Commission, normally would be satisfied after there has been a reasonably thorough discussion by the actuaries. The problem, as I've seen it, is that there is no one who really has any experience in this area involved in the purchase and sale of a particular company and it gets well along before anybody really does anything about it.

MR. MAYNARD: Does anyone want to suggest any helpful action as you see it - that the Pension Commission might take? Would you think that they could sound a note of warning to all the administrators of registered pension plans that the Pension Commission will not approve these changes in plan unless an agreement has been reached?

MR. MacDONALD: I found that one of the problems is that these purchase and sale negotiations are so confidential, they don't tell the pension plan administrator about it until it's much too late. Sometimes they don't even think they can tell their actuary early in the game and by the time they get the knowledgeable people involved, the lawyers have gotten too far along and there's been too much work done. You then try to clear up the mess.

MR. LANG: My feeling is that part of the issue here is one of education. Generally speaking, there are two other professional groups at the beginning of these situations - one being the accountants (there are generally several accountants on both sides involved in various ways), and the other, the legal profession. They definitely are involved in drafting the agreements. My belief is that our profession together perhaps with the regulators should set up to assist in the education of these other two groups. I think to look at trying to educate each individual at each corporation who perhaps are non-professionals, is impossible.

MR. MAYNARD: One way to get a start on this is if a group of actuaries who have experience in this field, perhaps under the aegis of the Canadian Institute of Actuaries, were to draw up a set of standards of good conduct that would be implemented in a well run merger and acquisition. If this document, with the blessing of the Canadian Institute of Actuaries, covered the various points needed in the discussion and perhaps the principles that should be considered under each topic, then it could be distributed to the parties to any possible merger/acquisition. Would this be a useful thing to do?

MR. LEE: Probably the most useful act would be to somehow communicate with the legal firms that if they proceed on a merger/acquisition/ divestiture and if there are pension plans involved and if they do not seek competent advice, then they do so at their peril. I'm sure that's not the appropriate language. Maybe Mr. Moore can tell me what the appropriate language is.

MR. MOORE: I think we have to be careful not to get into too much detail in the standards we set for our members, but there's no harm (the next time we look at recommendations for valuation of pension plans or any of the standards involving pension plans) in bringing the subject of mergers and acquisitions into it. I'm inclined to agree with both of the speakers in that our responsibility as individual members of the profession is one of communicating to the lawyers and accountants, and getting together with groups of them to inform them of the need for early actuarial advice. I had one lawyer representing a client come to me and say that he had felt that it was not necessary for us to become involved because there already was an actuary acting on behalf of the seller (I was acting on behalf of the buyer). I think that's an indication that the level of knowledge or understanding of the actuarial involvement is very low and demonstrates the lack of understanding of the financial impact that it can have on the negotiations.

MR. LEE: I was once asked to represent both sides (which I suppose somehow resolves the differences); however, it was very hard to resolve conflict of interest. I think Mr. Moore made an excellent point when he spoke about the valuations because sometimes they are so secret that the actuary doesn't know. However, the situation may be circumvented if, when one is presenting the valuation, an integral part of it is to indicate what the "true surplus" might be in a wind-up situation. You say that the reason you are doing that is because if you are involved in a merger acquisition with respect to this plan, this particular aspect may be an important part of the negotiations. This will prevent his wandering into the negotiations thinking it is alright because his assets and liabilities are roughly in balance on an ongoing basis so the pension plan is a non-issue. You have identified that it may be a very important issue and if you do it often enough (annual evaluations), eventually it sinks in not only to the Pension Administrator, but it in fact usually percolates up at least to the Vice-President, Finance and maybe the C.E.O.

MR. LANG: I think the only problem there Doug is that often the people who have copies of the valuation report know as little as you do about the sale until it's through.

MR. IAN MALCOLM: I work for Peat Marwick and as such, they do get into valuation of companies and they are tending to use the actuaries on staff more and more. I'm going through one right now and the difficulty there is that the company is being valued because the company wishes to be sold, but they haven't found a buyer yet. Earlier on we were talking about negotiations between two sides as to who will assume responsibility for future salary increases, who will have the responsibility for ad hoc increases to pensioners, and do you allow for increases in the Revenue Canada maximum even though it's not written into the plan document now. There is a completely different set of guidelines that one should come up with in those situations.

MR. LANG: I think this illustrates how interesting this topic is once we get into it. We haven't really devoted much time this morning to topics other than pension assets and liabilities. I don't know whether anyone might have some specific comments on multi-employer plans, particularly amendments required as a result of these situations. One point might be whether the merger/sale/spin-off will require the new entity to withdraw from the multi-employer plan after the closing date or whether they may be able to continue - depending on what type of plan it is. Whether an actuarial evaluation of all or part of the entire plan will be required in order to spin-off the new entity is an interesting point. Where you have a very small component of a large plan, the question arises as to whether in fact a valuation would be required of the whole thing. I would suggest the valuation be carried out where there is an unfunded liability but not in the situation where there is an obvious surplus. Another question is whether the liabilities or associated assets for service up to the closing date will be required to be withdrawn and transferred to the new employer's arrangements. In multi-employer situations, the assets and liabilities could presumably remain behind and something new would be opened up by the new employer. The other point that is important is the drawing up and registering of the new entity's plans with the authorities and ensuring registration, etc. Often one will find there are deadlines on these things and sometimes it is very difficult to meet the deadlines.

MR. MacDONALD: On the multi-employer, there is still another facet. I have seen cases where the purchaser has been told that they don't really have to worry about the pension plan - it's in the multi-employer plan, it will continue to be in that and it is not your concern at all. When you begin looking at the actuarial reports and some of the techniques the actuary for that plan has used, you say 'well yes, but I hate to tell you what your costs are likely to be in the year 1990 according to the valuation techniques'. I know in at least one case this stopped the sale.

MR. LANG: That again illustrates the point that a little knowledge can prove that the pension plan situation is one of the most important variables in the purchase/sale arrangement. I wonder if anyone has any comments or anecdotes about Golden Parachutes we hear so much about these days. As actuaries we don't get involved in these - either personally or professionally. I think the other area that I've had alot of trouble with is the special executive arrangements, because they're generally hidden away. It's only after the fact that they discover that there are such arrangements. They are generally unfunded. The promises can be quite vaque and the implications of the sale of the operation may not be adequately dealt with in these arrangements. We have been called upon from time to time to value these - both in these situations and more often on a continuing basis just to see what the level of liabilities are. It wouldn't surprise me if in the future these arrangements become more prevalent because of the continued Department of National Revenue restrictions on maximum pension benefits. From what I read in the U.S. publications, the Golden Parachutes seem to be extremely popular, although I gather there has been some litigation with respect to some of them. Within registered pension plans there often is nothing in the purchase agreement relating to the assets/ liabilities/obligations. It's even less likely that these arrangements will be dealt with. Yet often, the obligations are such that only an actuary could really handle the appropriate valuation. Although technically it's generally a fairly simple job of valuing an annuity at a specific rate and some other assumptions, the legal aspects become very very interesting. Of course, in the final analysis, we are probably not going to be called on to pass judgement on these.

MR. MALCOLM: I think usually in these situations these retiring allowances (or whatever they might be) are not significantly related to the total value of the company. I think in Canada, the Canadian Institute of Chartered Accountants requires some kind of a footnote or accrual to be used in financial statements for these things.

MR. LANG: Only when they are quote 'significant' and again when they in fact surface. The biggest single problem is actually finding out what is there, to whom it relates, and what are the obligations. I have seen some of these liabilities in Canada amount to $5 million a head, so they can be quite significant.

MR. LEE: I've never dealt with anything as rich as that. The key is to somehow locate the special arrangements. I've seen the purchase/sale agreement contain a warranty in which the seller somehow warrants or assures the buyer that there are no other retirement arrangments in existence other than those identified in such and such a schedule. The real purpose of these warranties is to cause the seller to see himself as having some kind of responsibility to identify these special deals. On a few occasions where that has been part of the agreement, the seller remembers that there was an arrangement for one or two executives and it's disclosed ($300,000-$400,000 per employee). The key is in fact to identify and locate them and after that it's relatively easy.

MS. NEELA RANADE: We just went through a huge divestiture where the regional telephone companies spun-off from AT&T. In terms of the other employee benefit aspects of the spin-offs, I wanted to mention that we are going through transfer of funds for the group life reserves because we do some funding for post retirement Group Life benefits. In the future, when we have perhaps more funding towards post-retirement health care benefits, I can see that there might be more transfers of funds with respect to Group Health benefits as well. I wanted to see if any other companies have seen transfers of funds with respect to the other employee benefits such as Group Life or Group Health.

MR. LEE: Long Term Disability is one. If it is self-insured, you've got some very significant liabilities - possibly as significant as your pension plan. It is a very large company that is self-insuring or going on an administrative services only basis with respect to Long Term Disability.

MR. LANG: We have one situation involving life insurance for retired employees where in a consolidation of some assets from different companies, they accepted a deferred obligation as far as accrued service to the date of consolidation was concerned. This gives us a pretty regular amount of business to value these obligations and a considerable amount to transfer over.

MR. JEFFREY P. PETERTIL: I am not a pension consultant, I am an insurance company consultant and health actuary. On this issue of Life and Health insurance, I think any company that has guaranteed or put a very loose definition of guarantee on Health benefits, may find a liability as large as the pension liability. There does not seem to be much of a recognition on the part of management of that and certainly not the deal makers in acquisitions and mergers, and as far as that goes, even on the part of the Society. I think this is the first meeting where we have had any kind of discussion of post-retirement benefits other than pensions. The panel discussion yesterday turned up some real horror stories and each panelist had at least one example of health liabilities being as great as pension liabilities and they are generally unfunded. I think that we're going to see more and more of this and there certainly is room for actuarial work on these lines.

MR. LANG: I think it is our responsibility, both to society as well as to our profession, to do something about this.