



DRAFT BULLETIN FOR:

**SURPLUS DISTRIBUTION AND TREATMENT OF
DEFICIT ON WINDING-UP**

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LEGISLATIVE REFERENCES:	<p>The Pensions (Superannuation Funds and Retirement Schemes) Act (the "Act") Sections 31 and 32</p> <p>The Pensions (Superannuation Funds and Retirement Schemes) (Governance) Regulations ("Governance Regulations") – Regulation 31</p> <p>The Pensions (Superannuation Funds and Retirement Schemes) (Registration, Licensing and Reporting) Regulations ("RLR Regulations") – Second Schedule</p>
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1.0 BACKGROUND

- 1.01 The allocation of pension surplus has historically been a complex and contentious issue. The Financial Services Commission (the "FSC") acknowledges that where surplus arises, the allocation can be disputed and contested by various stakeholders.
- 1.02 Assessing entitlements of participants and sponsors to surplus in compliance with the Trust requires an assessment of the current Trust Deed and Plan Rules along with previous versions of these documents which remain applicable notwithstanding amendments made to the documents over time.
- 1.03 Surplus distribution on winding-up of both registered and unregistered superannuation funds/retirement schemes, whether partially or in full, are subject to oversight by the FSC.
- 1.04 When a superannuation fund ("fund") or retirement scheme ("scheme") is being fully or partially wound up, the amount of liabilities of the fund or scheme must be determined by an actuary who is deemed suitable by the FSC. The determination of the liabilities and allocation of the assets are to be documented in a Winding-up Actuarial Valuation Report ("WAV"). Where there are surplus assets, a scheme of distribution of the surplus, certified by the plan's actuary and accepted by the trustees, is also to be included in the WAV. Similarly, if a deficit exists details of the proposed treatment is to be set out in the WAV.
- 1.05 The trustees are required to provide the FSC with a copy of the WAV within sixty (60) days of receipt.
- 1.06 This bulletin seeks to clearly outline some pertinent considerations which should be taken into account when determining how surplus is to be distributed upon the winding-up of a pension plan.

2.0 LEGISLATIVE REQUIREMENTS

- 2.01 Pursuant to Section 32 of the Act, if any surplus exists after discharging the liabilities of a pension plan, the trustees or provisional trustees must ensure that the plan's actuary verifies the amount of surplus and submit

a copy of the proposed Scheme of Distribution of Surplus to the FSC for approval. Sub-sections 3 and 4 of this provision also outline the FSC's authority to approve the proposed scheme of distribution of surplus or to amend it after consultation with the trustees who must distribute the surplus in accordance with the scheme of distribution approved by the FSC.

- 2.02 Section 32(5) of the Act stipulates that the FSC must have regard to the payment of assets per the following priority order:
- to the current pensioners and their beneficiaries.
 - providing additional benefits for the remaining members and their beneficiaries; and
 - payment to the employer (sponsor), in the case of a superannuation fund only.
- 2.03 Governance Regulation 31 states that if the FSC takes a decision that a proposed scheme of surplus distribution is to be amended, pursuant to Section 32(3) of the Act, the FSC must have regard to consideration of general equity and such other factors as are appropriate, when amending that scheme of distribution.
- 2.04 Items 30 through 32 of the Second Schedule of the RLR Regulations stipulate that the Constitutive Documents of a pension plan must provide for the method by which the surplus is to be allocated upon the winding-up and the treatment of surplus or deficit during the existence of the plan and on partial winding-up.
- 2.05 Section 31 of the Act outlines the priority order for the payment of all liabilities from the assets determined as at the winding-up date. Therefore, if the assets are not sufficient to cover all the liabilities due, the priority order outlined in Section 31 must be adhered to.

3.0 POLICY REQUIREMENTS

- 3.01 When evaluating the scheme of distribution of surplus or the treatment of a deficit, during the winding up of a pension plan, the FSC initially reviews the applicable Trust Deed and Plan Rules ("TDPR"). The TDPR can be highly prescriptive - specifically whether assets can or cannot be reverted to the sponsor and outlining methods for allocation of surplus or treatment of deficit. Alternately, TDPRs might be generic - allowing for surplus to be used to improve benefits, subject to statutory limits, or silent on the issues.
- 3.02 Any allocation of surplus or deficit being proposed must adhere to the provisions in the plan's Constitutive Documents. Allocations of surplus that breach fetters and restrictions enshrined in the Constitutive Documents must not be pursued. For example, an allocation that breaches a non-reversion clause in the TDPR expressly stating that a Sponsor is not entitled to any share of the surplus during the life of the pension plan or upon winding-up does not comply with the terms of the trust and will not be approved by the FSC.
- 3.03 The trustees are required to submit, in writing to the FSC, whether consideration will be given to the inclusion of members whose positions were made redundant within the last twelve months of the effective winding-up date in any distribution of surplus assets. The trustees must also indicate, if applicable, the rationale for not including such persons in any proposed distribution of surplus assets. The exclusion of members who were made redundant should be considered, as there may be cases where a phased layoff strategy was implemented with a clear intention to wind-up the plan, which was delayed in such a manner that adversely impacted the affected members.
- 3.04 The FSC will also consider the demographic profile of the members (membership status, age, pensionable service, gender, etc.), immediate pension entitlement for current pensioners, pensionable salaries, members' contributions (basic, voluntary and employer's), and any other benefits and entitlements (bonuses, transfer values, etc.), amongst other things, when assessing the surplus distribution.

- 3.05 A fund or scheme that is being wound up remains subject to the provisions of the Act and Regulations until all assets have been disbursed.
- 3.06 The FSC reserves the right to request further information and documents as necessary to complete its review and its assessment will not be completed until the matters requiring attention have been fully addressed.

4.0 ELEMENTS TO CONSIDER IN A SURPLUS ALLOCATION

- 4.01 **The TDPR** – Trustees and their advisors must thoroughly review and identify any specifications regarding who is entitled to receive surplus, how the surplus must be distributed and whether the employer's concurrence is required or if consultation-only would suffice.
- 4.02 **Non-reversion/Exclusive Benefit Clause** - Trustees and their advisors must conduct a thorough review of the plan's Constitutive Documents and determine whether there are stipulations that would restrict how surplus is allocated. If the current TDPR allow for the allocation of a portion of the surplus to the sponsor, the prior versions of the executed TDPR should also be reviewed to ascertain if there exists an amendment fetter¹ that would prevent the reversion of assets to the sponsor or a statement that assets should be used for the exclusive benefits of the members and their beneficiaries. If there are any such provisions, despite what is stipulated in the current TDPR, the sponsor would not be entitled to a portion of the surplus upon the winding-up of the plan. Where the current TDPR is silent on surplus distribution upon winding-up, the prior versions of the executed TDPR should be reviewed to ascertain if there exist any non-reversion clause(s) of assets to the sponsor or exclusive benefit clause in the preamble or the winding-up provisions of the TDPR.
- 4.03 **Maximum Limit** – Provisions of the TDPR may include language stipulating that the allocation of surplus should consider the allowable limits of the Income Tax Act ("ITA") or other relevant legislations, with the excess being reverted to the sponsor(s) or some other third party. Actuaries of pension plans are being advised that the pension limit provided for in the ITA speaks to the maximum pension benefits due while a plan is ongoing. As such, this limit **is not** applicable during the winding-up of a plan.
- 4.04 **Surplus Determination** - Trustees and the plan's actuary must conduct a thorough review to determine the source of the surplus amount. For instance, the breakdown of the sources may include the portion of the surplus that is attributable to interest gains, where members' accounts were being credited less than net yield. In the case of Defined Contribution plans, it is expected that surplus deriving from this source would be allocated to the members' account in such a manner that reduced that disparity between the net yield and credited interest. The surplus may also be attributable to, amongst other things, withdrawal gains, deriving from employer's contributions made on behalf of non-vested terminated members; and over funding for Defined Benefit plans, where the calculated (current and projected) liabilities are less than assets.
- 4.05 **Outstanding Contributions and Contribution Holidays** – The Act creates an obligation for outstanding contributions to be paid into a pension plan. Trustees should therefore make concerted effort to recover outstanding contributions owed by participating employers or members of the pension plan while the plan is ongoing and after a decision is taken for its winding-up. Upon winding-up, a plan's Constitutive Documents may allow for a portion of the surplus to be used to grant contribution holidays for the sponsor or be refunded to the sponsor, who may, in turn, wish to use all or a portion of that allocation to offset outstanding contributions. In cases where there are outstanding contributions as at the proposed winding-up date, the plan's actuary should ensure that outstanding contributions are considered in the determination of the plan's assets and outline in the WAV, its implication on the surplus allocation. If the employer is entitled to a portion of the surplus as per the TDPRs, consideration must also be given to the history of contribution holidays taken

¹ There may be amendment provision that states that there cannot be any amendment made to the TDPR that would result in assets of the plan returning to the sponsor.

by the sponsor since the plan's inception and legitimate expectations of the plan's participants when determining the portion of surplus to be allocated to the sponsor upon winding up.

- 4.06 **Allocation amongst participants** – The trustees have a fiduciary duty to all participants of the pension plan. While the law gives priority to pensioners in the distribution of surplus, no other membership group is more important than the other (actives, terminated, vested or non-vested). All participants are affected by the wind-up a plan and as such, unless specified by law or specifically outlined in the termination clauses of the TDPR, priority should not be given to any class of member above the others.

5.0 ELEMENTS TO CONSIDER IN A DEFICIT ALLOCATION

- 5.01 **The TDPR** - Trustees and their advisors must thoroughly review and identify any specifications as to how deficit should be treated; the methods of allocation (which members' benefits will be reduced and by how much); and if the employer's concurrence is required or if consultation only would suffice.
- 5.02 **Deficit Determination** - Trustees and the plan's actuary must thoroughly review and determine the source of the deficit amount, as well as method and timeline by which the deficit will be settled, if applicable.
- 5.03 **Allocation amongst participants** – In keeping with Section 31 of the Act, where the assets are depleted during the allocation of a particular class of members, the portion allocated within that group should be proportionately reduced for all members within that class. Depending on the nature and source of the deficit, benefits to members may not be reduced but the full payment to certain classes of members may be delayed until all or portions of the deficit are paid into the pension plan.

6.0 THE FSC'S APPROVAL/NON-OBJECTION

- 6.01 The FSC expects that it will be able to communicate its decision regarding a scheme of distribution of surplus or deficit allocation within five (5) months after receipt of all pertinent documents and information. Where more time is required to complete the review, the trustees will be informed.
- 6.02 The FSC reserves the right to:
- approve a proposed scheme of distribution of surplus, as submitted.
 - request a revision of the proposed scheme of distribution of surplus.
 - amend the proposed scheme of distribution of surplus after consultation with the trustees or provisional trustees.
- 6.03 In the case of a deficit allocation, the FSC will issue its non-objection where no concerns are identified with the proposed distribution or may request that further considerations be made, and the allocation revised.

Questions regarding this bulletin may be directed to:

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