Innovation, Science, and Economic Development Canada
235 Queen Street, 10th Floor
Ottawa, Ontario
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January 13, 2019

Attention: Mr. Mark Schaan

Re: Report of the IIC Task Force on Retirement Income Security

Introduction

The Insolvency Institute of Canada ("**IIC**") Task Force on Retirement Income Security (the "**Task Force**") respectfully submits this report ("**Report**") on your consultation document titled "Enhancing Retirement Income Security for Canadians" ("**Consultation Document**").

Firstly, by way of introduction, the IIC is Canada's premiere private sector insolvency organization. A non-profit organization, the IIC is dedicated to improving the insolvency process and enhancing the professional quality of, and public respect for, the insolvency and bankruptcy practice in Canada. Its membership is comprised of Canada's most senior and experienced insolvency and restructuring professionals in the legal, accounting and financial fields. The IIC's members have had leading roles in virtually every significant insolvency proceeding in Canada since its inception in 1990. The mission of the IIC is to promote excellence and thought leadership in commercial insolvency and restructuring policy and practice in Canada.

This Report has been prepared in response to your request for comments arising from your consultation document pertaining to retirement income security for Canadians ("**RIS**"), in furtherance of the initiative announced in the 2018 Budget to seek feedback from pensioners, workers, companies, experts and other stakeholders in order to take a whole-of-government, evidence-based approach towards addressing retirement security for all Canadians.

The Report is based upon the volunteer efforts of several members of the IIC who participated in a number of meetings organized by the Task Force. This Report has been provided to the IIC Board of Directors which supports the submissions. However, neither the Task Force nor the Board had an opportunity to undertake a broad consultation of the members to gauge their concurrence with the

comments, conclusions or recommendations formulated by the Task Force, due to time constraints. As a consequence, it does not purport to represent a consensus position of IIC members on all aspects.

The Task Force notes that the Consultation Document invites comments on a number of initiatives that aim to improve the RIS regime by reforming pension, insolvency and/or corporate governance legislation. In light of IIC's main focus, the Task Force has commented herein primarily on those initiatives that can be expected to have a significant insolvency implication in proceedings under the *Bankruptcy and Insolvency Act* (**BIA**")[1] or the *Companies' Creditors Arrangement Act* ("**CCAA**").[2] The Task Force's comments are therefor presented under the following headings:

- Super priority for unfunded pension liabilities and employee claims for the termination of employee benefits.
- Pension funding relief criteria.
- Enhanced "look back" period.
- Enhanced transparency in the CCAA process.
- Overall comments.

Super priority for unfunded pension liabilities and employee claims for the termination of employee benefits

This proposed course of action has been looked at before, many times, and comments on the pitfalls of such an option were given in submissions to the government in connection with the study of Bills C-476, C-487, C-501, S-214 and S-216 (40th Parliament, 3rd session).[3] The commentary made in those submissions is still relevant.

The fundamental conclusions of the IIC in this regard are that pension law reforms should be advanced in a non-insolvency context as employees will be most effectively assisted by non-insolvency related measures designed to protect pensioners. Effective pre-insolvency measures will limit the need for additional features when insolvency occurs. Attempting to address the related issues in the context of business insolvencies, particularly through a proposed super-priority for pension deficits, is commercially imprudent, ineffective and inappropriate (with the possible exception of unremitted pre-filing pension contributions, as mentioned below). The IIC is of the strong and unequivocal view that

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1 *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended.

2 *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended.

3 The submission was made in respect of Bills C-476, C-487, C-501, S-214 and S-216 (40th Parliament, 3rd session) and is dated August 31, 2010. A copy of the submission is appended hereto for your ease of reference.

a proposed super-priority for pension deficits will have a significant negative impact on access to capital in the business environment while doing little to address the economic and social policy goals of RIS for Canadians generally. The conclusions regarding the negative impact apply equally to measures designed to protect other employment termination obligations such as severance, termination pay, health benefits or long term disability benefits, inasmuch as these obligations are difficult to quantify or are not subject to a maximum amount.

Providing a "super priority" to ensure that unfunded pension liabilities are paid ahead of secured liabilities carries a very high risk of hampering access to credit, as secured lenders have no way to measure and monitor risk. We believe the impact would be greatest on operating credit, which is essential for day to day operations. The unfunded liability is an estimate made from a series of calculations and assumptions that take time to perform, and change with time based on economic conditions, interest rates and the performance of capital markets. As such, the exposure of lenders to a "super priority" that cannot be known or accurately quantified in real time or managed is likely to cause a contraction of credit.

Any contraction of credit is likely to affect solvent companies' access to the credit markets, and would therefore also affect the economy as a whole. A contraction of credit may trigger the insolvency of a business that would otherwise be solvent and/or restrict an insolvent business' access to interim financing during the restructuring process, which would be counterproductive to the objectives of insolvency legislation and would not be helpful to the goal of protecting retirement income of workers.

With respect to granting super priority status for employee claims for the termination of employee benefits such as life insurance, long term disability benefits or health and medical care benefits, the problem is the same from the secured lenders' perspective. While the exposure can be estimated at any point in time in respect of any employee's existing benefit, it is difficult or impossible to predict what the future costs of these benefits will be. Also, there is currently no product available to continue benefits into the future based on a one-time payment. As discussed above, any uncertainty regarding a lender's exposure could be expected to translate into a contraction of credit.

The Task Force strongly believes that legislating an additional super-priority, over and above those that presently exist, is ill-advised due to the risk of disruption in the availability of credit. In any event, such a measure should not be undertaken without a comprehensive discussion based on specific draft legislation with all stakeholders of the potential consequences and effects. The Task Force further believes that if a super-priority is to be considered, it should not be wide ranging but rather very constricted to ensure that the priority can be known and monitored by secured lenders and unsecured creditors, such that the risk can be measured, assessed and factored in credit granting decisions. This can be accomplished by limiting the super-priority to known amounts that are not paid on their due date and remain unpaid at the point of insolvency, and/or subjecting the super-priority to a set maximum amount.

Furthermore, inasmuch as the proposed protection takes the form of a "super priority", such protection could be illusory if the assets are insufficient to cover the entire unfunded pension deficit or employee benefit program. The creation of a "super priority" is merely a method of reallocating scarce resources among stakeholders, and does not ensure that the resources will be sufficient to fully cover the super priority claim. This further evidences the need for effective pre-insolvency measures and supports our overarching view that RIS reforms should be dealt with outside of the insolvency regime.

Pension Funding Relief

The Task Force sees the merit of pension funding relief in situations where an insolvency restructuring process can be averted.

To the extent that it is voluntary and represents a *quid pro quo* in the context of obtaining relief measures that are desirable for the business to continue, the Task Force believes it is reasonable that these be subject to agreement that the business abide by certain specified criteria or conditions, such as a prohibition on dividend payments while the measures remain in place. This, of course, requires that the specified criteria or conditions be predictable and transparent so that a business can request and expect to obtain the relief measures with full knowledge of what will be expected in return, to ensure that the measures would not be subject to a lengthy negotiation (or litigation) which would be counterproductive.

Enhanced "look-back" period

The Task Force notes that measures of protection already exist in legislation against abuse, oppression, improper conduct or breach by the directors of their fiduciary duties. The proposed measures described in the Consultation Document expand on an already existing and functional system, purportedly to enhance corporate accountability and better align corporate decision making with pensioners' interests. These new obligations are presumably aimed at controlling what is considered improper corporate behaviour after the fact, without providing a standard to gauge what constitutes improper behaviour.

This proposed solution in effect increases directors' liabilities, so it may very well restrict access to talent when it is most needed. This may also penalize directors and managers for economic/market changes over which they have no control, which is fundamentally unfair. It is important to ensure that if we put punitive measures in place, it is only to correct bad behaviour, not situations over which the managers have no control or have been diligent. Creating retroactive director liability in situations where pension deficits are in no way attributable to reprehensible director behaviour is not advisable or effective.

From a practical perspective, these types of changes could have unintended consequences due to the apprehension and alarm of managers or directors that their compensation might be clawed back or that their personal liability could be engaged without any deliberate malfeasance. The unintended consequences include:

- Discouraging talented managers from acting as directors.
- Accelerating the shift amongst employers from DB to DC plans.
- Increasing compensation rates for management, as an additional risk premium.
- Legislation shopping, if the measures are introduced in a particular corporate statute (such as the *Canada Business Corporations Act*[4]) and not in others.
- Increasing the cost of director's and officer's insurance.

As well, more research is required to assess the criteria that could be used to gauge what constitutes "excessive" bonuses or compensation in the circumstances. The assessment of what may constitute an excessive compensation for an executive is likely a perception or "eye of the beholder" issue.

Enhanced transparency in the CCAA process

The Consultation Document suggests that one of the measures that could be envisaged would be greater transparency in the CCAA process, although the Consultation Document does not indicate what transparency is presently thought to be lacking, or how pensioners might derive a financial benefit from any such additional transparency.

As a general comment, the Task Force agrees that transparency is conducive to better cooperation and efficiency in the restructuring process and, as such, acknowledges that an objective of enhancing transparency may have merit. However, the Task Force notes that the BIA and CCAA are already premised on a high degree of transparency and ease of access to the Court.[5] For example, the BIA and CCAA already provide for the possibility that stakeholder groups could be represented in insolvency proceedings, and that the funding for this representation could be assured through a court ordered charge if this is necessary for the effective participation of such stakeholder in the proceedings.[6] The system as it is presently designed provides by default that each stakeholder involved in the

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[4] *Canada Business Corporations Act*, R.S.C. c. C-44, as amended.

[5] Also, as a court officer, the Monitor provides a high level of transparency and is generally acutely aware and protective of the interests of pensioners and employees.

[6] See section 64.2 BIA and section 11.52 CCAA.

proceedings pays its own costs, with a possibility of discretion in certain cases where the stakeholder's participation is desirable and would not be possible without funding by the debtor. This design is preferable to the U.S. system where the insolvent person bears a significant portion of the costs of significant stakeholders, as it promotes efficiency and discourages lengthy or costly litigation.

We further note that pensioners and employees with pension plans may have representation either through an independent plan administrator or through the union if there is a collective bargaining agreement ("**CBA**"). Retirees and other employees have the right to engage counsel on their own as an interested group. As mentioned above this may be at the debtor's expense if this is necessary for their effective participation in the proceedings.

Some of the measures that are suggested may have merit; however, the Task Force is of the view that they do not effectively protect the DB participants. If the entity lacks resources to cover a pension deficit, the improved transparency and increased participation might help plan members understand why their benefits need to be adjusted, and may give them a voice in negotiating a reduction of the plan liabilities, but these would not in and of themselves prevent a financial loss if the participation in the pension plan makes the business non-viable.

That said, insolvency proceedings are intended to help provide a level playing field so that debtors and creditors can come together and negotiate a compromise that will provide a better result than an outright liquidation and will avoid the social costs associated with a sudden, uncontrolled business failure. This process cannot occur efficiently if there is an informational imbalance or a marked disequilibrium in the negotiating forces. As such, measures that are designed to promote the efficient sharing of relevant information to affected stakeholders are a worthwhile endeavour.

One of the proposed solutions addressed in the Consultation Document is limiting the scope of initial orders. The Task Force presumes that this measure refers more particularly to the authorization customarily given to insolvent debtors to suspend payment of the special payments when a pension plan is in a deficit position. The Task Force notes that at the time a debtor company wants to avail itself of the relief contemplated in the CCAA, cash preservation is of prime importance and the debtor company cannot afford at that time to pay what is in effect an unsecured pre-commencement debt or obligation. The main components of an effective insolvency system to permit restructuring are twofold: firstly, a process to prevent a dissipation of assets while restructuring occurs or negotiations are held with the stakeholders, in other words a stay of proceedings to prevent a "race of the swiftest", and secondly, a process to compel a minority to abide by the decisions of the majority, in other words the legislated process by which all creditors are bound by the proposal or plan if it has received the required level of support. The ability to suspend payment of pre-commencement debts or obligations, i.e. the first component, is essential to accomplishing the restructuring objectives and any weakening of this provision by giving one unsecured creditor group an exemption from the provisions, essentially a super priority in another form, which would undoubtedly reduce the efficiency of our insolvency statutes and

limit the chances of a business to continue/restructure. We note that the suspension of these payments in no manner affects any rights that have already accrued.

Another proposed solution in the Consultation Document pertains to the possibility of imposing an express duty of good faith on all participants to the restructuring. While the Task Force believes that the codification in the CCAA and in BIA of an overarching duty of stakeholders to act in good faith is worthy of consideration, eventual legislative reform should be mindful of not distorting common law or civil law principles or possibly creating fundamental divergences in the way BIA and CCAA processes could be managed in Québec and in the rest of Canada. The Task Force considers that additional research is warranted to assess differences existing between common law and civil law jurisdictions in this regard with a view to avoiding a legislative change that may result in creating undue legal uncertainty and differences in approach across Canada.

It should also be borne in mind that under the CCAA, the court has very broad discretion to render any order it deems appropriate in the circumstances.[7] The CCAA court may thus adjudicate matters equitably without the formal codification of a duty of good faith.

Overall comments

For the reasons explained earlier herein and in the submissions made in the past, the Task Force believes that any measure of protection for DB plans should not come at the point of insolvency, but rather through measures that ensure that the plans are properly capitalized on an on-going basis. Due to the potential risk to access to credit associated with measures designed to provide a "super-priority" protection at the point of insolvency, the Task Force believes such measures to be ill-advised.

To the extent however that enhancing protection for DB plans or plans providing health benefits or long term disability benefits ("**LTD plans**") is considered a must as part of any revision of the RIS system, the Task Force would recommend that any measure implemented to protect the possible deficit of DB plans or liability under LTD plans should follow the following principles:

- The measure should depend as little as possible on relief arising from insolvency statutes. The best protection measure for a DB plan is having funding rules that are designed to prevent the occurrence of a deficit in the first place. As such, emphasis should be placed on better monitoring of the plans' financial positions; a conservative approach to contributions based on estimated yields; a taxation incentive to maintaining the funds fully funded; and transparency on corrective measures when the fund shows signs of an impending deficit.

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7 See section 11 CCAA.

The comment applies equally to LTD plans, as there will be less risk associated with such plans if the potential future liability is covered by a properly segregated fund.

The reason why the measure should depend as little as possible on relief from insolvency statutes is that at the point of insolvency, there is much uncertainty regarding the value of the assets of the insolvent employer, in particular if the going concern assumption is in doubt. The loss in value of the assets in the context of an outright liquidation, the need to provide for the professional fees required to administer the insolvent estate and the competition for resources to cover other socially important claims such as payroll source deductions, environmental claims, decommissioning costs, etc., make it uncertain that sufficient resources will exist to protect the employees' benefit claims.

- For the reason mentioned in the paragraph above, to the extent there is a need to protect employees against the impact of a deficit in a DB plan or an obligation arising from a LTD plan, a measure that does not rely on the underlying value of the assets is preferable. This can be accomplished by spreading the risk of loss among all employers, for example by establishing a national system of pension benefit guarantees funded by premiums charged to all employers who have DB plans.
- To the extent that a "super priority" is considered as a "fall back" measure in the event of insolvency, which measure is not supported by the Task Force, the super priority should be transparent, known and predictable, in order to avoid or limit the disruption in credit availability. We refer the reader to pages 3 and 4 of this Report.

All of which is respectfully submitted on behalf of the Board of Directors of the Insolvency Institute of Canada and the members of the IIC Task Force. We would be pleased to discuss with you any questions or comments you may have.

January 13, 2019

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