Comments of the

Canadian Federation of Pensioners

regarding

Review of

Bankruptcy and Insolvency Act

and

Companies' Creditors Arrangement Act

July 2014

Contents

Executive Summary

Pensioners have earned their pensions through a lifetime of work. Pensions are deferred wages, as confirmed by the Supreme Court of Canada.[1] Pensioners cannot relive their years of employment; they are in no position to replace pension losses with some other form of income. Because pension plan underfunding is commonplace, when the financial health of a company is in jeopardy, that company's pensioners are the most vulnerable to its insolvency.

With today's insolvency legislation, when a company is insolvent and its Defined Benefit (DB) pension plan is underfunded, pensioners are certain to suffer pension losses. Despite the provisions cited under the title "Enhancing Equity" in the consultation paper, in practice the protections for pensioners are weak and highly inadequate for retirees, especially in the case of underfunded pension plans. Though provincial and federal pension legislation purport to provide some protections for the amounts owing to a pension plan, insolvency legislation does not preserve that protection for the vast majority of those amounts. Consequently, pensioner protection in insolvency is largely illusory.

As Professor Sarra (UBC) has put it: "Canada falls near the bottom of more than 60 countries in its protection of employees and pensioners in insolvency".[2] The analysis provided by Professor Secunda (Marquette Univ.) places Canada in the bottom quintile among OECD nations with respect to the risk to which pensioners are exposed when their plan sponsor is insolvent.[3]

In this submission, the Canadian Federation of Pensioners recommends legislative amendments that would preserve the protections intended by the deemed trusts conferred by pension legislation, and recommends the extension of that protection to all amounts owed to a DB pension plan. In particular, the recommendations are:

- give effect to the pension deemed trusts created under federal and provincial legislation in all insolvency proceedings;
- grant pensioners priority over secured creditors to amounts covered by a deemed trust, no matter when the security was granted to the lenders;
- ensure the pension deemed trusts are given effect even if the plan is wound-up after the insolvency proceedings have commenced; and
- if Parliament is unwilling to make such changes, extend the secured priority ranking that currently applies to unpaid normal costs today to all amounts owing to the plan.

These recommendations would mitigate the losses that pensioners currently suffer when their DB pension plan is wound-up when underfunded. At the same time, they would redress the

[1] *IBM Canada Limited v. Waterman*, 2013 SCC 70, para [4].
[2] Dr. Janis Sarra, "Examining the Insolvency Toolkit, Report of the Public Meetings on the Canadian Commercial Insolvency Law System", July 2012, page 96.
[3] See section 4, which summarizes **"**International Treatment of Pension and Wage Claims in Company Insolvency Proceedings", P.Secunda, September 2013, pages 46-47.

imbalance of security among creditors in a way that is more likely to lead to successful reorganizations.

Given the particular vulnerability of pensioners in insolvency and the many means that commercial lenders have to mitigate their own risks, it is time to update insolvency legislation in a way that supports the pensions that have been earned by Canadians during their working lives.

Introduction

The Canadian Federation of Pensioners (CFP) is an association of Canadian organizations, each of which advocates for the Defined Benefit (DB) pension plan interests of their members. Collectively, the CFP member organizations represent 250,000 individuals across Canada. The member organizations of CFP are listed in the Appendix.

CFP welcomes the opportunity to provide suggestions to the Minister of Industry regarding the *Bankruptcy and Insolvency Act (BIA)* and the *Companies' Creditors Arrangement Act (CCAA)*. Our recommendations are directed towards strengthening the security of the pensions that have been earned by members of DB pension plans in those cases where the pension plan sponsor is insolvent and the plan is underfunded.

Section 1 explains the significant impact that insolvency legislation has regarding a pensioner's retirement income. Under the current laws, DB pension plan underfunding on plan wind-up in insolvency results in significant losses to pensioners' monthly pension benefits.

Section 2 describes the shortcomings of current insolvency legislation with regard to its ability to support the pensions that have been earned by DB plan members and on which they rely for their later years.

Section 3 presents legislative remedies for these shortcomings.

Section 4 illustrates that on the international stage Canada lags behind in respect of the protections that insolvency legislation affords to pensioners.

Section 5 examines means other than insolvency legislation that could be considered to mitigate pensioner risk. It is shown that though these other measures are helpful, they do not diminish the need for the legislative amendments that are recommended in Section 3.

Section 6 summarizes these submissions and underlines the need for explicit protection for pensioners under the CCAA and BIA.

1.0 The Role of Insolvency Legislation in keeping the Pension Promise

Retirees who are members of DB plans have completed their lifetime of employment, and by providing services to their employers, have earned the pensions that are the financial foundation for their senior years. Their pensions are compensation for the work that they have already rendered to their employer. The Supreme Court of Canada has recognized pensions as deferred compensation:

> "Pension benefits are a form of deferred compensation for the employee's service and constitute a type of retirement savings."[4]

For most retired members of DB pension plans, their pensions make up the single largest portion of their income, and they are particularly vulnerable to any loss of this income. In their retirement years their options to generate income become increasingly limited. They have no recourse to recoup any loss of pension through other means. They are not able to re-enter the labour force; they are not able to find some additional source of income. A younger individual who suffers a job loss faces difficulties, but at least he or she has the opportunity to seek income elsewhere. Of all those who rely on the financial well-being of a company, pensioners are the most vulnerable.

Further, because pension benefits have been accruing, access to save under other retirement saving vehicles has been restricted. RRSP contribution room has been reduced by the existence of their promised pensions. It is all the more important for government to support the promises made to pensioners, given that the government has curtailed their savings opportunities because of these promises.

Governments can help support the pension promise through legislation and supporting regulations. First and foremost among these are the rules established for plan funding and governance. These are found in federal legislation and regulations for federally-regulated plans, and in provincial legislation and regulations for provincially-regulated plans. These rules are not impacted by the BIA or CCAA, and therefore are not the subject of these comments.

---

[4] *IBM Canada Limited v. Waterman*, 2013 SCC 70. para [4].

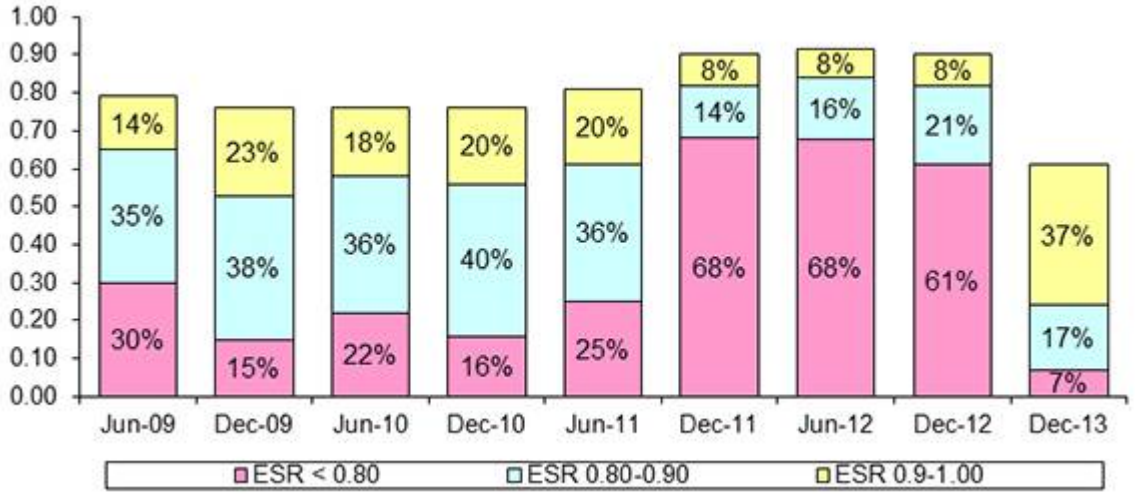
The BIA and CCAA are important when the plan sponsor enters bankruptcy proceedings and the plan is wound-up in an underfunded position. In this situation, the pension plan does not have enough assets to cover all of the employer's obligations to its members, and the plan sponsor no longer funds the plan. Currently, pension plan members are almost certain to face pension losses under these circumstances. Only a small fraction of the total amount owed to a DB pension plan is given meaningful protection in insolvency.

Plan underfunding is not an academic concern for pensioners; it is real and significant. The following data provided by the Financial Services Commission of Ontario (FSCO) and the Office of the Superintendent of Financial Institutions (OSFI), who are respectively the regulators for Ontario and federally-regulated pension plans, illustrate the risks of plan underfunding faced by DB pension plan members.

Figure 1 depicts the average expected solvency ratio for federally-regulated plans.[5] It demonstrates that in 2013, 61% of plans were underfunded; 24% of plans were underfunded by at least 10%; and 7% of plans had a shortfall of at least 20%. Even though funding problems persisted in 2013, the funding status of that year was a marked improvement over the funding status for the period between 2009 and 2012. For example, in 2012 nine out of every ten plans were underfunded, with six out of every ten plans having a shortfall of at least 20%.

[5] Office of the Superintendent of Financial Institutions, InfoPensions Issue 11, May 2014.

Figure 1: Percentage of Plans with Estimated Solvency Ratio < 1.0



For Ontario-regulated DB pension plans, the funding status is even more sobering. Figure 2 illustrates the annual aggregate funding ratios for the 2008 through 2013 period. It is the wind-up ratio that gives the proportion of a plan's liability that can be covered by the plan's assets should the plan need to be wound-up.[6] For instance, in 2013 over all Ontario-regulated plans, only 70% of the plans' liabilities are covered by the plans' assets. Absent protection of the amounts owing to the plans under the BIA or CCAA, this means that, on average, if a plan had been wound-up, pensioners would have faced a 30% reduction to their pension payments.

[6] For Ontario-regulated DB plans, solvency valuations are permitted to exclude certain plan benefits, such as indexation. The "wind-up" ratio includes all plan provisions for Ontario plans, as does the solvency ratio for all federally-regulated plans. Accordingly, the wind-up ratio for Ontario plans and the solvency ratio for federally-regulated plans are comparable measures of the extent to which the plan can meet its wind-up obligations.

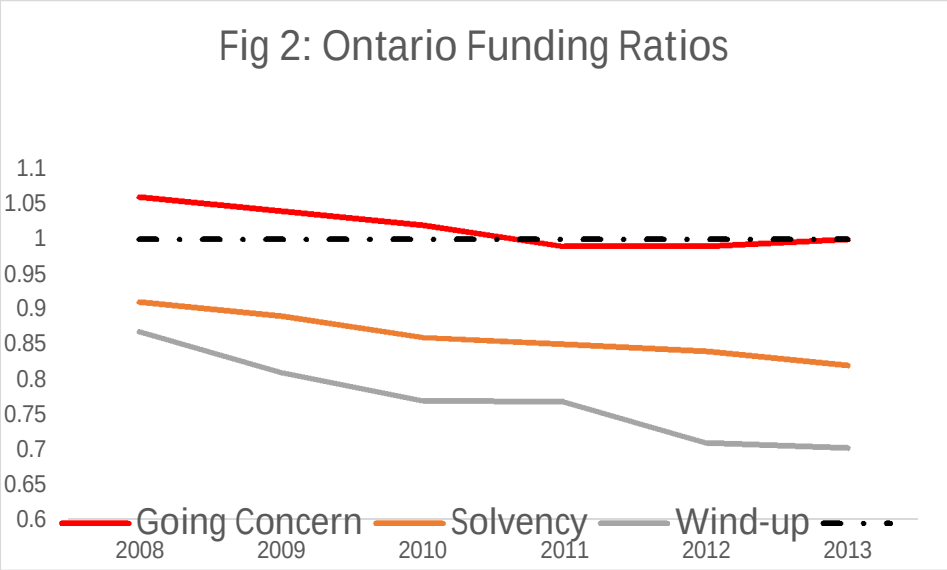


Fig 2: Ontario Funding Ratios
1.1
1.05
1
0.95
0.9
0.85
0.8
0.75
0.7
0.65
0.6
Going Concern
Solvency
Wind-up
2008
2009
2010
2011
2012
2013

2.0 Pension Protection in Current Insolvency Legislation is weak

The consultation paper, under the title "Enhancing Equity", states that "employees benefit from numerous legislative and regulatory protections, as well as government programs, not available to other creditors." Pensioners are included among "employees". A cursory review of the paper may lead to the conclusion that pensioners are well-protected. In practice, however, while the protections for pensioners under provincial and federal pension legislation appear to be helpful, these protections are in practice weak and are further frustrated by the judicial interpretations given to the BIA and CCAA. The protections pensioners are left with in insolvency are extremely weak and highly inadequate.

All jurisdictions in Canada have passed special protections for pensioners.[7] Crucially, to protect the pensions earned by employees, every jurisdiction confers a deemed trust over the assets of an employer for amounts owing by the employer to a pension plan.

For instance, for federally-regulated DB pension plans, the *Pension Benefits Standards Act* (PBSA) specifies those amounts which are to be held separate from the employer's moneys, and which are deemed to be held in trust for active and retired pension plan members, and to form no part of the estate of the employer in liquidation, assignment, or bankruptcy.[8] These amounts are:

- the moneys in the pension plan
- prescribed payments, which would include the normal costs
- payments required under a workout scheme
- amounts deducted by the employer from members' remuneration that have not been remitted to the pension plan
- other amounts due to the pension plan from the employer including
    - the face value of a letter of credit should it not be honoured by the issuer
    - special payments due in the year of the employer's insolvency

[7] *Pension Benefits Act, 1992*, S.S. 1992, c. P-6.001; *Pension Benefits Standards Act,* R.S.B.C. 1996, c. 352; *Employment Pension Plans Act*, R.S.A. 2000, c. E-8; *Pension Benefits Standards Act, 1985*, R.S.C. 1985, c. 32 (2nd Supp); *Pension Benefits Act,* R.S.O. 1990, c. P.8; *Pension Benefits Act 1997*, S.N.L. 1996, c. P-4.01; *Pension Benefits Act,* C.S.M., c. P32; *Pension Benefits Act*, S.N.B. 1987, c. P-5.1, *Pension Benefits Act,* R.S.N.S. 1989, C. 340. Prince Edward Island is the only exception to the foregoing. It passed pension legislation in 1990 but it has not been proclaimed.

[8] *Pension Benefits Standards Act*, Sections 8(1) and 8(2).

In Ontario, the *Pension Benefits Act*[9] protects all amounts owing to the plan to be held in trust by the employer for the benefit of the members of the plan. In *Indalex*[10], the Supreme Court of Canada held that the Ontario *Pension Benefits Act* confers a deemed trust on the entire wind-up deficit, subject only to the doctrine of paramountcy.[11] Ontario pension legislation, therefore, explicitly recognizes that all amounts owing by an employer to the pension plan are covered by the deemed trust.

As confirmed in *Timminco*, Quebec's pension legislation confers a deemed trust on special payments due in the year of insolvency.[12] In that case, the judge concluded that a deemed trust existed for the special payments already due, and that, by virtue of the provisions of Quebec's pension legislation,[13] the amount owing to the pension plan for unpaid special payments was held by the court to be in priority to secured creditors.

Unfortunately, this federal and provincial pension legislation has been frustrated by other judicial decisions not giving effect to these deemed trusts in BIA and CCAA proceedings. Meanwhile, to the extent that the BIA and CCAA protect pensions at all, the protection in practice is negligible.

2.1 Trusts conferred by Pension legislation are not given effect in insolvency

It is a fundamental rule that amounts held in trust by a debtor are not subject to distribution to creditors in a bankruptcy proceeding.[14] However, the Supreme Court of Canada has held that provincial deemed trusts are not applicable in a bankruptcy, unless the BIA expressly provides for same.[15] Even federal pension legislation has been successfully attacked. The *Aveos* decision of the Quebec Superior Court[16], pertaining to a federally-regulated DB pension plan, holds that unless a provision of the CCAA or BIA explicitly provides for priority ranking of an amount, whether or not that amount is held in trust, then that amount is not a priority claim. With deemed trust provisions in the PBSA, Parliament, much like the provinces, evidently felt the need to

[9] *Pension Benefits Act* (*OPBA*), R.S.0. 1990, c. P-8.
[10] *Sun Indalex Finance LLC v. United Steelworkers*, 2013, Supreme Court of Canada.
[11] Section 57 of the Ontario *Pension Benefits Act* stipulates that contributions required of the employer that are due are held in trust, and upon wind-up contributions that are not yet due are also deemed to be held in trust for the beneficiaries of the pension plan. Section 30.(7) of Ontario's *Personal Property Security Act* states that other security interests are subordinate to the deemed trust conferred by the OPBA.
[12] *Timminco*, Quebec Superior Court, No. 500-11-043844-121, January 24, 2014.
[13] Section 264, *Supplemental Pension Plans Act.*
[14] *Bankruptcy and Insolvency Act*, Section 67.(1)(a).
[15] *Henfrey, Samson & Belair Ltd.*, [1989] 2 S.C.R. 24.
[16] Quebec Superior Court, *Aveos Fleet Performance Inc.*, judgment provided November 20, 2013.

protect pensions by creating deemed trusts. The need for their continued application in insolvency is set out in Section 1. Their potential ineffectiveness in insolvency is an outcome of *Aveos* that should be overturned by legislative amendment as set out in Section 3.1 below.

2.2 Federal Deemed Trusts can be negated by the existence of secured creditors

In *Aveos,* the Quebec Superior Court held that the secured claim of creditors over collateral ranks ahead of the PBSA deemed trust, rendering the PBSA of virtually no benefit to pensioners of federally-regulated pension plans. The deemed trust arose upon the insolvency of Aveos, which would not have been before the CCAA filing, or at the earliest when a special payment became due following the actuarial valuation report. The deemed trusts, then, are considered not to arise until or shortly before the plan sponsor faces insolvency.

In that case, which would be the circumstance in many similar situations, certain property of Aveos was encumbered by security in favour of secured lenders. The Quebec Superior Court found that "the deemed trust provision cannot be effective unless it is first determined that there is some unencumbered asset out of which the trust may be deemed". Consequently, the *Aveos* case suggests that the deemed trust conferred by the PBSA becomes ineffective in the presence of secured creditors, and is at least subordinate to the priority of the secured creditors.

As a result, Aveos' creditors are free to secure their loans on the entirety of the assets of the plan sponsor, notwithstanding the existence of or potential for DB pension plan underfunding. By doing so they can defeat the protections conferred by the deemed trust provisions of the PBSA.

The deemed trusts established by provincial and federal pension legislation are not conditional. Rather, the legislation specifies that those amounts – independent of any considerations of other creditors – are to be held in trust to the benefit of pension plan members. The Aveos decision underlines the necessity for amendments to the BIA and CCAA that would give effect to the protections intended by the deemed trust provisions of the PBSA. The amendment, recommended in section 3.2, would give effect to the deemed trust provisions already conferred by pension legislation.

2.3 Provincial Deemed Trusts may be negated if the Plan is wound up following insolvency

In most insolvencies, a company will not wind up a pension plan before it enters into insolvency protection. It is more common for a company to abandon an underfunded pension plan and leave it to a pension regulator to take over the plan and wind it up. This means that in many cases an underfunded pension plan will be wound-up after the insolvency proceedings have commenced, and may have a wind-up date after the insolvency filing.

This timing issue can create a problem for the effectiveness of the deemed trust, whether that deemed trust is established by provincial or federal statute. This issue was touched on in *Indalex*. In that case, the Executive pension plan had been neglected by the employer and abandoned, and was not wound-up until after insolvency proceedings had commenced. In the ruling of the Supreme Court of Canada in that case, some judges implied that the deemed trust was effective, and others held that the deemed trust could only be effective if the pension plan was wound-up at the outset of CCAA proceedings. In the case of *Grant Forest Products Inc.*, the CCAA judge held without clear authority that the "deemed trust that arises upon wind-up prevails when the wind-up occurs before insolvency as opposed to the position that arises when wind-up arises after the granting of the Initial Order."[17]

Consequently, negligent or deliberate acts of the company that fail to wind-up the plan can, at least according to one interpretation, undermine the deemed trust priority for pension plan members and by doing so defeat a priority claim of its own retirees contrary to pension legislation. Clarity is required on this point. Section 3.3 recommends legislative amendments that would preserve the deemed trust provided by pension legislation, irrespective of the timing of the plan wind up.

2.4 The current normal cost contributions priority is highly inadequate

The current express BIA and CCAA protections for pension plans – providing a secured claim for unpaid normal cost contributions owing to pension plans is essentially meaningless for pensioners because normal cost contributions are a negligible amount owing to a pension plan. In addition, in the case of asset sales under the CCAA, s. 36(7) of the CCAA actually fails to even

[17] *Grant Forest Products Inc. (Re)* 2013 ONSC 5933, 30 September 2013, para [71].

protect normal cost contributions owing to the plan as the provision requires amounts under s. (4)(a) and 5(a) to be paid, whereas the applicable sections ((5)(a) and (6)(a)) were intended to be referenced instead, but were mis-numbered due to a drafting error.

By only giving priority status to the normal cost contributions owed to a plan, the remaining amounts owing to plans are treated as unsecured debt. The failure to even protect amounts currently due to a plan is unprincipled as there is no basis for distinguishing between normal costs owing on the one hand and special payments due on the other, or, in the case of federally-regulated plans, payments due under the Distressed Plan Workout Scheme (DPWS). In his 2011 report[18], Professor Davis (UBC) notes that the rationale for the priority ranking for normal costs applies equally to the special payments due. He notes that the plan sponsor is not permitted to confer an advantage to the non-pension creditors relative to the pension creditor. If the sponsor deliberately chooses to pay the non-pension creditors while avoiding the remittance of pension contributions, then an advantage is conferred. Davis characterizes granting priority to arrears as removing the incentive for engaging in illegitimate actions (i.e. conferring advantage).

Nevertheless, at present, only normal cost contributions owing are protected and there is an accordant likelihood that the pension plan will suffer the effects of the plan underfunding as the balance of the amount owing is unsecured. It is often the case that no meaningful portion of the bankrupt's assets will be available to unsecured creditors. As mentioned by Professor Secunda in his report prepared for Industry Canada[19] in this review, recovery of any unsecured debt is unlikely. Among similar statements, he observes "if a pension or wage claim is given a relatively low priority among a company's creditor[s], there is every chance that the employee will not receive any pension or wage payments for these claims."

It cannot be said that pensioners are well-protected. To illustrate the severity of this treatment, consider a federally-regulated DB pension plan sponsored by an employer that is facing bankruptcy. To simplify the situation, the example assumes a single-employer non-contributory pension plan which has a solvency valuation of $10B, and market assets of $7B at the time of the most recent plan valuation; that is, a solvency deficiency of 30%.[20] The employer would be

[18] R.Davis, IRPP Study No.16, **"**Is Your Defined-Benefit Pension Guaranteed?"**,** March 2011.

[19] **"**International Treatment of Pension and Wage Claims in Company Insolvency Proceedings", P.Secunda, September 2013.

[20] For this example, the average wind-up deficiency of all Ontario-regulated DB plans in 2013 is used.

required under federal-funding rules to make a special payment of 20% of $3B, or $600M, in the year. It would also be required to pay the plan's normal costs of, say, $150M.[21] Under provincial and federal pension legislation, the wind-up deficit would be protected. Yet in bankruptcy, the $3B would be considered unsecured debt. As a consequence, pensioners would almost certainly suffer a 30% reduction in pension payments. Amendments to redress this situation are set out in section 3.4.

[21] Normal costs will vary by plan, but can be expected to be in the range of $150M for a plan of this size.

3.0 Recommended Amendments to Insolvency Legislation

Section 3.1 proposes amendments that would have the effect of preserving the deemed trusts conferred by pension legislation. Section 3.2 ensures that these trusts would not be frustrated by secured creditors. Section 3.3 proposes amendments that would avoid the harm that is currently visited upon pensioners due to an employer's negligence or deliberate failure to wind-up its pension plan. Section 3.4 presents the amendments necessary to appropriately protect pensioners in insolvency situations, including protection for the amount of any wind-up deficit.

3.1 Deemed Trusts should be given effect

Pension legislation, both provincial and federal, is clear that special payments due to the plan are held by the employer in trust, for the benefit of plan members. Treating these amounts as unsecured debt in insolvency subverts the legislative intent of conferring a trust on the amounts owing. If giving effect to a priority claim on this amount does not flow from the existence of the deemed trust, then conferring a deemed trust would appear to be of no practical effect.

Though existence of a deemed trust conferred on amounts owing to plans should, by the definition of a deemed trust, be sufficient to ensure that special payments would be made on a priority basis to the pension plan, that has not been the case. To add clarity and certainty to this situation, section 67 of the BIA needs to be amended to explicitly recognize the continuing validity of deemed trusts established under the PBSA and analogous provincial pension legislation. As such, this amendment would give effect to the Federal PBSA and resolve the inconsistency between two equally valid federal laws. Even if the PBSA is effective in bankruptcy, provincial deemed trusts have been held to be ineffective, resulting in an obvious unfairness in that the beneficiaries of a PBSA deemed trust may have priority in bankruptcy whereas the beneficiaries of a provincial pension deemed trust may not. Extending this protection to provincial pension plans ensures fairness through consistency of treatment. Further, while Parliament has jurisdiction over bankruptcy and insolvency law, the provinces have jurisdiction over pensions and personal property security laws and Parliament should respect the constitutional power of the provinces to determine issues of civil and property rights and ensure

that deemed trusts, whether created provincially or federally continue in bankruptcy. Further grounds for such an amendment are set out in Sections 1, 3.4 and 4.

3.2 Deemed Trusts should be given effect over secured creditors

Section 2.2 above describes how secured creditors can effectively overturn the deemed trust conferred on amounts owed to a federally-regulated plan. This timing issue arises because the deemed trust is viewed as not arising until after the assets of the company have been encumbered by a secured creditor.

In *Timminco*, which concerned a Quebec-regulated DB pension plan, the deemed trust conferred on the special payment due superseded the ranking of secured creditors. The judge noted that section 30(7) of Ontario's *Personal Property Security Act* (PPSA) would have the same effect for Ontario-regulated plans. The language of section 30(7) of Ontario's PPSA has been held by the courts to effectively give priority to the Ontario *PBA* deemed trust over secured creditors.[22] That section reads:

> *30(7). A security interest in an account or inventory and its proceeds is subordinate to the interest of a person who is the beneficiary of a deemed trust arising under the Employment Standards Act or under the Pension Benefits Act.*

Consequently, the following should be included in the PBSA, with the language repeated in the BIA and CCAA:

> *A security interest in an account or inventory and its proceeds is subordinate to the interest of a person who is the beneficiary of a deemed trust arising under the Pension Benefits Standards Act or under an act of a provincial legislature providing for prescribed pension plans.*

The public policy rationales for such a change are set out in Section 1, 3.4 and 4.

3.3 Deemed trusts should be given effect, whether the plan is wound-up prior to or after the commencement of insolvency proceedings

Section 2.3 illustrates that legislative amendments are required to remove doubt concerning the effectiveness of the deemed trust, even when the pension plan is wound-up after insolvency

[22] As was noted above in the discussion regarding Timminco.

proceedings have commenced. The timing of the plan wind-up is in the hands of the insolvent company and after insolvency with the pension regulator. Plan members are in no position to ensure that plan wind-up occurs prior to the commencement of insolvency proceedings. Given the words in *Grant Forest Products Inc.*, if wind-up precedes the insolvency proceedings, the deemed trust has effect. Otherwise, its effect is unclear and can be to the disadvantage of the DB plan members, including pensioners.

The deemed trust should be preserved by amending pension legislation to state that amounts owed to the plan upon wind-up are deemed to have been due prior to the date of any restructuring event. For federally-regulated plans, for instance, this language can be inserted into section 29(6.1) of the PBSA.

The Ontario PBA already contemplates the effectiveness of the deemed trust even if a plan is wound-up after the insolvency proceedings have begun. Section 57(4) of the PBA applies the deemed trust "where a pension plan is wound up", not "when" it is wound up. The precise timing of the wind up is not determinative of the effectiveness of the deemed trust. The Ontario pension legislation adopts the principle that the deemed trust should have effect should plan wind-up be inevitable, and whether or not the wind-up occurs before or after the commencement of insolvency proceedings.

For greater certainty, and to honour the intent that underpins the deemed trusts, corresponding language should be inserted into the BIA and CCAA.

3.4 If Parliament is unwilling to make the above changes, the amounts owing to plans in respect of the wind-up deficits should be granted the same secured status as currently given to unpaid Normal Costs

If Parliament is not willing to expressly recognize provincial pension deemed trusts in the BIA and CCAA then it should extend secured status to all amounts owing to the plan, including special payments together with the wind-up deficit, at the same ranking as unpaid normal costs.

CFP believes that the balance of interests lies in recognizing the federal and provincial pension deemed trusts in insolvency, or in the alternative, granting priority ranking for all amounts owing

to pension plans on a super-priority basis ranking equally with the security currently granted to normal costs owing.

In discussing the relative ranking of secured debts and amounts owed to DB pension plans, it has been suggested that if secured debt were not to rank above those pension amounts access to capital would be made more difficult for employers. For instance, the cost of capital would increase to offset the increased risk that would accompany a reordering of the priority. In the extreme, the argument goes, access to capital would be cut-off entirely for some particularly risky borrowers, or the increase in the costs of borrowing would be just what is needed to push some into bankruptcy. The conclusion of the argument is that lenders need the protection of priority ranking, relative to amounts owed to pension plans.

This is not a new argument; it has been advanced in the past to argue against previous reforms to help pensioners. However, no firm evidence has ever been advanced to support the argument. Pensioners should not continue to be subordinated on such speculative grounds. As Professor Sarra notes, the facts regarding the impact of greater pensioner security on credit do not support the argument.

> The modest priority changes brought into force in 2008 were contested by some parties on the basis that credit markets would be negatively impacted. Yet comparison with similarly situated jurisdictions, with considerably more protections in place, ***suggests that credit availability has not been impacted in the way feared***. All parties to *CCAA* proceedings are aware of concerns regarding changing priorities. Fear of credit loss is a fair consideration, but given the changing nature of the credit market, particularly where creditors have increasingly hedged against their potential losses, the priority granted to the most vulnerable stakeholders needs further consideration. [emphasis added] [23]

Information has been provided regarding the possible impact on the cost of capital should the full amounts owed to pension plans be given a priority ranking. In the course of the debate on Bill C-501, which had proposed a super-priority[24] for amounts owed to pension plans, estimates in the range of 12 to 25 basis points were advanced. In the testimony of Ms. Urquhart[25] regarding the proposals in C-501, she noted that her estimate of 20 basis points was consistent with the

[23] Dr. Janis Sarra, "Examining the Insolvency Toolkit, Report of the public meetings on the Canadian commercial insolvency law system", July 2012, page 96.
[24] C-501 would have placed claims for all unpaid amounts owed to a DB plan ahead of secured debt.
[25] Transcript of the proceedings of the Standing Committee on Industry, Science, and Technology, Tuesday Nov. 16 2010, pp 2-3.

range of 12 to 25 basis points advanced by Phillips, Hager & North, and was consistent with the 25 basis points estimated by Towers Watson.

The specter that some employers might be pushed into default due to the impact on the cost of capital, assuming that could be the case, reinforces the need for priority protection of the wind-up deficit. If a plan sponsor is so close to default that a minor increase in the cost of raising capital would push it into default, then any minor event in its business plan could have the same result. It is the members of the pension plan of such an employer that priority ranking of the full amounts owed to the pension plan is most likely to help. Ultimate bankruptcy is almost a certainty if the firm cannot withstand a minor buffeting, and the pension promise made to its pensioners would accordingly be at great risk. If the pension plan is underfunded at the same time as the sponsor enters bankruptcy, then priority ranking of all amounts owed should help regain some of the pension that has been earned by the plan members.

If it is the case that the cost of capital would reflect the risk borne by lenders should the employer default, then employers would necessarily have an increased incentive to minimize plan underfunding, thereby reducing lenders' perceived risk. At the same time, lenders know through their basic due diligence, the extent to which a borrower's pension plan is underfunded. Lenders are able to stipulate in the terms of their agreements with borrowers the manner in which their borrowing terms are linked to the funding status of the pension plan. A plan that is well funded would present no risk to a lender, and should result in no increase in the cost of capital. Providing greater security to pensioners through the proposed amendments to the BIA and CCAA would enhance employers' incentives to keep pensions properly funded. As a result, pensioner risks would be reduced through the combined operation of pension regulations and these increased financial incentives felt by employers and lenders.

The plan deficiency is in the nature of a loan from the pensioners collectively, to the plan sponsor. The deficiency is, by definition, an amount that is needed in the plan so that the plan, upon wind-up, can meet its obligations. But that amount is not in the plan, rather it resides in the hands of the sponsor. The sponsor can therefore use that amount for purposes other than funding its pension plan and without informing the pension plan members. However, it should be recognized that this practice amounts to a loan from the pension plan members to the plan

sponsor. When seen in this light, the disparity of approach to different types of lenders is illustrated. Voluntary lenders who are "secured creditors" have priority access to the bankrupt's assets despite being in the business of running investment risks[26], able to bargain for a risk premium, able to assess the credit risk of an employer and diversify their investments. Conversely, involuntary lenders who are pension plan members are among the "unsecured creditors", unable to take security, for whom no alternative sources of income are unavailable and for whom RRSP contribution room has been taken away. These most vulnerable and non-consensual creditors stand far less chance of recouping what is owed to them.

To use the language of the full title of the CCAA[27], it is not a fair "compromise" to provide priority recovery to secured creditors ahead of pensioners. Nor is it sound public policy.

The inequity in approach to secured creditors, as compared to pensioners, is all the more apparent given the fact that secured creditors have other means of hedging their investment risk. Buying debt at a discount and covering losses with credit default swaps are two scenarios in which secured creditors are paid, ahead of pensioners, for losses that they have already taken steps to avoid. It is this reality of the credit market to which Professor Sarra has alluded in the quotation above. CFP agrees with Professor Sarra's conclusion that "the priority granted to the most vulnerable stakeholders needs further consideration".

Furthermore, it is not sound public policy to subject pensioners to pension losses, and subsequently expose social security programs to the risk of having to backstop those losses. Those with DB pension plans are far less likely to rely on social security. Fifteen percent of those with a defined benefit pension plan collect the Guaranteed Income Supplement, compared to as many as 50% of retirees without one.[28] The taxpayer ultimately bears the burden of privileging secured creditors over pensioners.

Further, the incentives for a successful reorganization of a company is enhanced if secured creditors are given an incentive to compromise with pensioners. Currently, secured creditors may have an incentive to force a bankruptcy if they can improve their recoveries. The pensioners

[26] Comstock Canada Ltd., Endorsement of Justice Newbould, October 2, 2013 CV-13-10181-OOCL.
[27] Act to facilitate compromises and arrangements between companies and their creditors.
[28] As reported by McMahon and McQueen, Macleans, 3 June 2014, citing a Boston Consulting Group study of 2013.

have an interest in the continuation of the firm and the ongoing operation of the pension plan. The practical and desirable outcome of giving a higher priority for amounts owing pension plans is to incentivize secured creditors to negotiate collaboratively with pension plan members to reach a mutually beneficial compromise.

As noted above, from a pensioner's perspective, a plan deficiency becomes a sudden, and meaningful, loss of income. Throughout her lifetime, a pensioner may have faced such a loss before; jobs do end, and employers do downsize. The difference in this instance, though, is that there is little, if any, recourse generating new income in some other way. A seventy- or eighty-year old is not going to get a job elsewhere to make up pension losses. By contrast, a lender or supplier of services or goods to a debtor still has an opportunity to recover its losses or altering its business plan.

There is further difference. The loss of a job and its income represents the lost opportunity for an employee to provide services and earn wages in the future to that employer. Pension losses in insolvency, on the other hand, represent the loss of wages that have been earned for the services that have already been provided by an employee. Parliament should be cognizant that an underfunded plan in insolvency is not just "bad luck" for pensioners. It is a promise broken; it is wages earned and not paid, and that loss directly harms a pensioner's standard of living. Parliament should better support the recovery of deferred wages that have already been earned by an employee.

4.0 Canadian Pensioner Exposure to Insolvency Risk is High

The salient consideration for Canadian DB plan members, whether employees or pensioners, is the degree of risk they face with regard to the pensions that they have earned. Predictability and security are highly prized in this consideration. Most importantly, the prospect of pension loss arises when a plan is not fully-funded and is unable to meet all of its obligations, at the same time as the plan sponsor is unable to continue or to contribute to the pension plan. Accordingly, pensioner security is bound up with the likelihood that a pension plan is underfunded together with the measures, if any, that would mitigate the impact of that underfunding. A weighing of relative risks faced by pensioners across jurisdictions would have to consider the following factors:

(A) ***The extent to which the pension rules, encompassing funding, governance practices and regulatory oversight, ensure that a pension plan will, at any time, be fully-funded***

If, for instance, the funding rules are sufficiently robust so as to ensure, with a high probability, that a plan would be fully-funded no matter what befalls the plan's sponsor, then a plan member could rightly conclude that he or she faces little risk to the pension promise. As noted below, in his paper prepared for Industry Canada as input to this review, Professor Secunda, Professor of Law, Marquette University Law School[29] observes that in 27 of the OECD countries, pensioner exposure to poor funding is limited, either because the plans are state-run and therefore not exposed to employer failure, or because the statutory plans limit pensioner exposure to unpaid contributions but not to unfunded liabilities.

If, on the other hand, plans are commonly poorly funded and pensioners are exposed to that underfunding, then the pension rules are inadequate to mitigate pensioner risk. As is noted in section 5.1 below, plan funding is not exemplary in Canada. This factor alone gives concern to pensioners. CFP and its member organizations have advocated for many years for stronger pension rules that would strengthen the security of the pension

[29] **"**International Treatment of Pension and Wage Claims in Company Insolvency Proceedings", P.Secunda, September 2013.

promise. The shortcomings of the current pension rules, and their remedies, are not germane to the review of BIA and CCAA. Suffice it to say that the instances of plan underfunding have been common, and Canadians would be foolhardy to assume that pension rules are capable, on their own, to ensure the pension promise.

(B) ***The extent to which measures mitigate the risk to the pension promise when the employer is insolvent and the plan is underfunded***

Even with poor funding and sponsor insolvency, pensioner harm can be curtailed if there are other measures that make up for the pension plan deficiency. Insurance schemes, including pension Guarantee Funds, are one example. If full DB pension payments can be achieved by supplementing the amounts from the plan fund with insurance or guarantee fund payments, then pensioners would be held harmless.

Another example of a harm-mitigating factor is the protection that could be provided through insolvency arrangements. For instance, if all amounts owed to a DB pension plan were afforded a super-priority, or were not considered a part of the bankrupt's estate, then pensioners could rely on the insolvency arrangement to make up a substantial portion of the pension losses that would otherwise have resulted from the plan underfunding.

Professor Secunda has described both pensioner exposure to employer failure, and the protections afforded to pensioners in OECD countries when employers fail. For instance, he notes the role of supervisory authorities in some instances, and observes that pensioner risk is limited to unpaid contributions in others. The paper describes the extent to which pensioners are protected in insolvency arrangements, and the extent to which insurance schemes and guarantee funds are available to mitigate pensioner losses.

Professor Secunda summarizes the approaches adopted across the OECD in the following way:

(a) State-run plans: Pensioners are insulated from the effects of employer failure as the state undertakes to pay the promised pensions. Hence, pensioner risk arising from insolvency in these seven countries is very low.

(b) Statutory plans: In these twenty jurisdictions, pensioner exposure to employer failure is limited to unpaid contributions, and not unfunded pension liabilities. Hence, the scope of pensioner risk is limited.

(c) Employer-operated plans: In these seven jurisdictions, including Canada, the tendency is to have priorities for pension claims in insolvency, and to have guarantee schemes.

A comment on the Canadian situation is necessary: the priority for Canadian pension claims is very limited, as discussed in Section 2; a guarantee scheme provides little protection for plans regulated in Ontario, and there is no guarantee scheme for those regulated in other Canadian jurisdictions. The only guarantee scheme in Canada pertains to those plans that are regulated in Ontario, and the amounts that can be recovered from that scheme are limited to $1000/month. In fact, a pensioner could only receive $1000/month if his/her pension plan was entirely without funds. More typically, if a pension plan had a deficit of 30%, which could easily mean a loss of $1500/month to an individual pensioner, the Ontario Guarantee Fund would only pay $300/month. Professor Secunda describes far more generous guarantee funds in the other OECD countries.

The “priority” for pension claims is limited currently to normal costs, and for special payments due in some circumstances. All other amounts owed to the plan are treated as unsecured, and therefore unlikely to be recovered in insolvency. In recent years, the normal costs of DB pension plans amounted to a small fraction of the unfunded liabilities owed to the plan. Hence, priority in Canada is provided to only a small amount of the total owed to the plan, and so pensioners face significant pension losses with employer insolvency.

Because Canada is not among the 27 countries operating state-run or statutory plans where pensioner exposure to risk is limited, and because the protections it provides in the form of insolvency law or guarantee funds is very low, CFP concludes from Professor Secunda’s analysis that Canada is in the lower quintile of OECD countries in respect of pensioner protection when a plan fails.

Professor Sarra has compared the protections provided to Canadians by insolvency law to the same situation faced by pensioners in other jurisdictions, and has found Canada wanting.

> The most recent legislative amendments enhanced the priority of wage and pension claims under Canadian Insolvency Law. Still, internationally, Canada falls near the bottom of more than 60 countries in its protection of employees and pensioners in insolvency. Canada should consider further enhancement of the priorities granted.[30]

Considering the very real risk that private DB pension plans can be underfunded when employers fail, the fact that Canadian plan members are fully-exposed to this underfunding, and the limited scope of protection provided by either guarantee schemes or insolvency legislation, the conclusion is inescapable. Compared to other OECD countries, Canada is doing a poor job in protecting its vulnerable pensioners. Canada's protection of DB pensioners from the risk of employer insolvency cannot be said to be in the "mainstream" of OECD practice, as Professor Secunda has characterized it[31]. Rather, Canada is lagging behind its OECD counterparts, as Professor Sarra has observed. The much-needed amendments to insolvency legislation proposed by CFP herein may allow Canada to join the mainstream.

[30] Dr. Janis Sarra, "Examining the Insolvency Toolkit, Report of the Public Meetings on the Canadian Commercial Insolvency Law System", July 2012, page 96.
[31] Professor Secunda, op. cit., page 61.

5.0 Other Means of Reducing Pensioner Risk

The potential for a guarantee fund has also been raised. The notion is that if there were a pension guarantee fund that would backstop the underfunding of a terminated plan, making it whole upon termination, then there would be no need to address the disposition of pension shortfalls in bankruptcy proceedings. Pensioners could be satisfied with insolvency legislation only if there was a guarantee fund sufficiently robust to ensure that pension shortfalls could be made good at all times. The fact is that a comprehensive and effective guarantee fund does not exist in Canada. Section 5.2 discusses this issue further.

The inevitable conclusion is that insolvency legislation should be amended so that they can better protect the security of pensions.

5.1 Funding Rules

For the hundreds of DB pension plans regulated federally, the weighted average estimated solvency ratio (ESR) has been below 1.0 since June 2008. In December 2012, the ESR was at 0.83, illustrating that on average federally-regulated plans were 17% underfunded, on a solvency basis. Figure 1 illustrates that 61% of plans had a shortfall of at least 20%.[32] Funding status improved in 2013 relative to a year earlier, however even with that improvement, three out of every five plans were underfunded.

Most Canadian DB plans are regulated in the province of Ontario. Figure 2 and the most recent report of the Financial Services Commission of Ontario on the funding of DB plans[33] highlight the deterioration of funding performance in Ontario. Some highlights of the 2014 report are:

- The median solvency ratio was 82%. That is, half of the plans were underfunded by at least 18%.
- 91% of plans were less than fully funded on a solvency basis.
- 95% of all plan members were in plans that were not fully funded on a solvency basis.

[32] InfoPensions 09, Office of the Superintendent of Financial Institutions, May 2013.
[33] "2013 Report on the Funding of Defined Benefit Pension Plans in Ontario, Overview and Selected Findings 2010-2013", Financial Services Commission of Ontario, March 2014. The analysis uses the reporting statistics associated with 1361 pension plans.

- 72% of plans reporting in 2012 had a solvency deficit of at least 20%.
- On aggregate plan liabilities of $220B, there was an aggregate wind-up deficit of $65B. That means that on average, for an Ontario plan that is forced to wind-up coincident with bankruptcy, a pension shortfall of close to 30% can be expected.

In Quebec, a committee was charged to make recommendations that could turn around the chronic plan underfunding that has been apparent for Quebec-regulated plans for some time. In its comments to the Committee on its recommendations[34], CFP has warned that their recommendations are likely to add to the funding problems of these plans, rather than correct the situation.

If plan underfunding was an isolated or rare instance, it might be concluded that policy makers need not worry about pensioners losing income when plan sponsors enter bankruptcy. It could be concluded that no matter what happens with the plan sponsor, its pension plan would be capable of meeting its obligations. The facts, though, are different. Plan underfunding is a material and persistent problem, both federally and provincially. It is obvious from figures 1 and 2 that the funding rules have not removed the risk that pensioners face when their underfunded plan terminates. The likelihood that a plan is underfunded when it is terminated is unacceptably high. The plan shortfalls – which are the pensioners' greatest risk – are material.

It is true that federally-regulated pension plans benefit from the pension reforms of 2010. But that fact alone does not mean that they are exempt from the possibility of plan termination and plan underfunding coinciding, as the statistics show. There has been less success in Ontario and Quebec with regard to pension reform, and the incidence of plan underfunding in these jurisdictions is very troubling to plan members.

CFP acknowledges that plan funding rules are not within the ambit of the BIA and CC*AA*, and therefore these comments do not propose funding measures that would strengthen pensioner security. We wish to stress, however, that the facts are that the funding rules have shown

[34] Expert Committee on the Future of the Quebec Retirement System, "Innovating for a Sustainable Retirement System", 2013.

themselves inadequate to ensure pensioner security. Changes to insolvency legislation are therefore required.

Further, when a plan member finds that he is facing an income loss because his underfunded plan is being terminated, it is too late to consider what the funding rules are or should have been. Even if it were the case, as it clearly is not today, that his predicament was rare, it would be of no comfort to him. The facts would be that his plan is underfunded, he is facing a financial dilemma he had not bargained for, and his last opportunity to stem the losses to some extent lies with the protections afforded to him in insolvency legislation.

5.2 Guarantee Fund

A guarantee fund can be used to defray, or eliminate, the effects of plan underfunding when an underfunded plan is terminated. In theory, those amounts owed to the plan would be made available from the guarantee fund, making the plan whole or in a better financial position, and allowing pensioners to receive the pensions they had earned, or at least, lose less.

If the guarantee fund limited the amounts that it would make available, then pensioners would still need protection for the difference between the plan deficit and the amount paid by the fund. The greater the limitations, the greater the need for provisions in insolvency legislation to protect the amounts owed to the pension plan.

The absence of a national pension guarantee fund is yet another reason why Canada's insolvency laws need to be amended to better protect pensioners, as explained in this submission. Unlike the United States, which has a national Pension Benefits Guarantee Corporation, Ontario is the only jurisdiction in Canada with a guarantee fund, the Pension Benefits Guarantee Fund (PBGF). However, the PBGF only covers members in Ontario, does not cover all pension plans, and the amounts that can be recovered from the PBGF are very limited and are capped to cover a benefit of $1,000/month. The fact that the PBGF is often underfunded itself is a complicating factor that could further reduce its scope of assistance to pensioners. Pension guarantee funds in the U.S. and the U.K. are far more generous than the PBGF. But even in these jurisdictions, pension plans are not necessarily "made whole" by their guarantee funds.

CFP acknowledges that a national guarantee fund would be useful to better protect the pension promise for all Canadians when a plan is underfunded. Given that none exists at this time, improvements in the BIA and CCAA for pensioners are warranted.

6.0 Conclusion

DB pensioners are the most vulnerable of all those who rely on the financial well-being of an employer. They have earned their pensions through a lifetime of work, and have every reason to expect that government laws will support payment of the deferred compensation for which they bargained, and for which they have already fulfilled their part of the bargain. Under current insolvency legislation, only a small portion of what is owed to them is afforded protection. .

Today's insolvency legislation does not give effect to the larger share of the protections provided in federal or provincial pension legislation. Insolvency legislation should be amended to bring it into conformance with the objectives of pension legislation. Indeed, it is time to extend those protections to all amounts that are owed to a DB pension plan.

The argument that has been used to justify priority to secured creditors over DB pensioners is unsubstantiated conjecture. Giving priority protection to secured creditors over pensioners amounts to shifting the investment risk of creditors onto pension plan members, or onto social security programs. Neither is sound public policy. In any event, Professor Sarra has observed that credit markets have not been impaired as has been conjectured. This review gives the government the opportunity to act to protect those who are most vulnerable when an employer is insolvent, and thereby address this inequity.

CFP recommends legislative and regulatory amendments that would:

- give effect to the pension deemed trusts created under federal and provincial legislation in all insolvency proceedings;
- grant priority over secured creditors to amounts covered by a deemed trust, no matter when the security was granted to the lenders;
- ensure the deemed trust is given effect even if the plan is wound-up after the insolvency proceedings have commenced; and
- if Parliament is unwilling to make such changes, extend the priority ranking that currently applies to unpaid normal costs today to all amounts owing to the plan.

Funding rules have proven incapable of relieving pensioners of the risks of insolvency, on the contrary, as the prevalence and persistence of underfunding attests. A national pension benefit guarantee fund that would be an effective backstop for a plan that is wound-up when it is underfunded should also be considered.

The fact that “Canada falls near the bottom of more than 60 countries in its protection of employees and pensioners in insolvency”, as Professor Sarra has concluded, makes the changes recommended by CFP all the more urgent.

Appendix: Member Organizations of the Canadian Federation of Pensioners

Air Canada Pionairs

Bell Aliant Pensioners' Association of Newfoundland & Labrador

Bell Pensioners' Group

Catalyst Salaried Employees & Pensioners Association[35]

CC Retirees Organization[36]

DuPont Invista Pensioners Association of Canada

GENMO Salaried Pensioners Organization[37]

International Air Transport Association Retirees

KODA Retirees Association[38]

MacMillan/Bloedel Weyerhauser Salaried Employee Club

Municipal Retirees Organization Ontario

Novartis/Ciba Retirees Group

Nortel Retirees Protection Canada

Ontario Northland Pensioners Association

Regroupement des Employés Retraités White-Birch Stradcona

Rio Algom Salaried Retirees

Store and Catalog Retirees Group[39]

Society of Energy Professionals Pensioners' Chapter

Stelco Salaried Pensioners Organization

Yellow Pages Pensioners Group

[35] Registered name is CSEP Advocacy Association.
[36] Salaried retirees of Chrysler Canada.
[37] Salaried retirees of GM Canada.
[38] Pensioners of KODAK Canada.
[39] Retirees of Sears Canada.