ACPM/ACARR
The Association of Canadian Pension Management
L'Association canadienne des administrateurs de régimes de retraite

May 19, 2010

Hon. James M. Flaherty
Minister of Finance
Department of Finance Canada
140 O'Connor Street
Ottawa, ON K1A 0G5

Hon. Tony Clement
Minister of Industry Canada
C.D. Howe Building
235 Queen Street
Ottawa, Ontario K1A 0H5

Dear Messrs. Flaherty and Clement:

**Re: Federal Bills re Priority of Pension Liabilities in Bankruptcies and Insolvencies**

I am writing to you on behalf of the Association of Canadian Pension Management ("ACPM"), the informed voice of Canadian pension plan sponsors, administrators and their allied service providers. Established in 1976, the ACPM advocates for an effective and sustainable Canadian retirement income system through a nonprofit organization supported by a growing membership and a team of volunteer experts. Our members are drawn from all aspects of the industry from one side of this country to the other. We represent over 300 pension plans consisting of more than 3 million plan members, with total assets under management in excess of $300 billion.

The ACPM promotes its vision for the development of a world leading retirement income system in Canada by championing the following Guiding Principles:

- Clarity in legislation, regulations and retirement income arrangements;
- Balanced consideration of other stakeholders' interests; and
- Excellence in governance and administration

***Issues of Concern to the Pension Industry***

Bill C-476 (a private member's bill) and Bill S-214 (a Senate Bill) are substantively similar pieces of legislation that propose to amend the *Bankruptcy and Insolvency Act* (the "BIA") and the *Companies' Creditors Arrangement Act* (the "CCAA") to ensure that defined benefit pension plan deficits are accorded the status of secure debts (the "Proposed Legislation"). We would like to express our concern to you about the potential impact of the Proposed Legislation on the Canadian retirement income system should any of these Bills become law. We support your statements that reforms to the retirement income system should "do no harm", but we must advise that these Bills would do significant harm. We do, however, understand the concern with securing benefits for members of defined benefit plans and make several suggestions at the end of this letter how to do so in a balanced manner.

In short, the Proposed Legislation may attempt to secure defined benefit pension plan deficits at the expense of the corporate ability to operate and obtain capital. As explained below, existing legislation provides a comparable level of protection provided in other pension systems. If the Proposed Legislation is put in place, however, it would weaken the financial strength of employers providing pension plans, and retirees and other retirement savers holding corporate investments (in their RRSPs or otherwise) could lose substantial value in their retirement plan assets.

***Current Treatment of Pension Obligations under the BIA and the CCAA***

In cases involving bankruptcies or receiverships, subsections 81.5(1) and 81.6(1) of the BIA provide that where the bankrupt is an employer who participates in a prescribed pension plan, the following amounts are secured by security over all the assets of the bankrupt employer (if they remain unpaid on the bankruptcy date):

- the sum of all contribution amounts deducted from employees' salaries, but not remitted to the pension plan fund;
- the "normal cost", which is defined by subsection 2(1) of the *Pension Benefits Standards Regulations, 1985* (the "PBSR") as meaning the cost of benefits, excluding special payments, that are to accrue during a plan year as determined on the basis of a going concern valuation; and
- the sum of all contribution amounts owed by an employer to a defined contribution pension plan.

Collectively, (a), (b) and (c) shall be referred to as the "**Unremitted Pension Plan Contributions**".

The security granted by subsections 81.5(1) and 81.6(1) of the BIA is provided with priority pursuant to subsections 81.5(2) and 81.6(2) of the BIA, respectively, over every other claim, right, charge or security interest against the bankrupt's assets, regardless of when that other claim, right, charge or security interest arose except in respect of certain specified claims (e.g., the rights of unpaid suppliers to repossess goods and the rights of employees to security for unpaid wages).

In cases involving proposals under the BIA or restructuring proceedings under the CCAA, subsections 60(1.5) and (1.6) of the BIA and subsections 6(6) and (7) of the CCAA provide that, where an employer participates in a prescribed pension plan for the benefit of its employees, the court will approve a BIA proposal or a CCAA plan of compromise or arrangement if:

(a) the BIA proposal or the CCAA plan of compromise or arrangement provides for the payment of Unremitted Pension Plan Contributions; or

(b) the relevant parties have entered into an agreement, approved by the relevant pension regulator, respecting the payment of these Unremitted Pension Plan Contributions.

These provisions effectively provide Unremitted Pension Plan Contributions with a "super priority", given that the BIA proposal and the CCAA plan of compromise or arrangement cannot be implemented unless Unremitted Pension Plan Contributions are fully paid or all the relevant parties agree otherwise.

Currently, Unfunded Pension Plan Liabilities (as defined below) are not afforded "super priority" rights under the BIA and the CCAA that rank ahead of secured creditors and it is important that this remain the case.

***The Proposed Legislation***

In respect of cases involving bankruptcies or receiverships, Bill S-214 proposes amendments to subsections 81.5(1) and 81.6(1) of the BIA, whereby if an employer participates in a prescribed pension plan for the benefit of its employees, "any amount considered to meet the standards for solvency determined in accordance with section 9 of [the PBSR]" required to be paid by the employer to the pension plan fund (the "**Unfunded Pension Plan Liabilities**"), shall also be secured by security over all the assets of the bankrupt if these amounts are unpaid to the pension plan fund on the bankruptcy date. Unfunded Pension Plan Liabilities relate to special payments that most employers are required to make over time to fund pension plan deficiencies. As a consequence of subsection 60(1.6) of the BIA, the Unfunded Pension Plan Liabilities would be granted the same priority as that currently held by Unremitted Pension Plan Contributions (described above).

In respect of cases involving proposals under the BIA or restructuring proceedings under the CCAA, Bill S-214 proposes amendments to subsection 60(1.5) of the BIA and subsection 6(6) of the CCAA, whereby if an employer participates in a prescribed pension plan for the benefit of its employees, the court would only approve a BIA proposal or a CCAA plan of compromise or arrangement if it also provided for the payment of Unfunded Pension Plan Liabilities, unless the relevant parties have entered into an agreement, approved by the relevant pension regulator, respecting the payment of both Unremitted Pension Plan Contributions and Unfunded Pension Plan Liabilities. These amendments would have the overall effect of extending the "super priority" currently held by Unremitted Pension Plan Contributions to Unfunded Pension Plan Liabilities, with the practical consequence that the BIA proposal and the CCAA plan of compromise or arrangement could not be implemented unless such amounts were paid or all the relevant parties agree otherwise.

***Issues and Concerns with the Proposed Legislation***

While the Proposed Legislation initially appears to be aimed at protecting the pension benefits of Canadian employees, a laudable goal, a more detailed analysis reveals that it may end up having the opposite effect by weakening the financial strength of plan sponsors and harming the retirement income potential of an even greater number of Canadians.

Alterations to the carefully calibrated bankruptcy and insolvency priority scheme, such as those in the Proposed Legislation, are likely to cause negative ramifications for pension plans and their sponsors in the credit market.

For instance, if the Proposed Legislation comes into effect, a wide array of creditors, such as banks and bondholders, would see their interests suddenly become subordinate to potentially substantial Unfunded Pension Plan Liabilities. This increased lending risk would likely have the effect of instantly depressing the value of corporate bonds issued by such employers, and such corporate bonds are widely held by Canadians in their retirement savings portfolios and registered pension plans. In addition, this new lending risk is likely to be reflected by an increase in the cost of borrowing, which may limit the availability of credit to plan sponsors who rely on the capital markets to finance their businesses and put Canadian companies at a competitive disadvantage to companies in other countries that do not have to give preferred creditor status to Unfunded Pension Plan Liabilities.

In addition to these potential adverse effects on the credit market, in extreme cases the Proposed Legislation may cause plan sponsors to borrow to make immediate further contributions to fully fund their pension plans in order to get continued access to credit – the additional debt burden could put some employers out of business. Another unintentional consequence of a sudden increase in the total amount of secured debt carried by plan sponsors, is that it may trigger an event of default under existing financing agreements. In addition, lenders may refuse to take on the increased risk of offering new financing to distressed sponsors, which could accelerate bankruptcies.

***<u>Full Consideration of All Options</u>***

In the ACPM's view, the current protections afforded to pension plan contributions in an insolvency are adequate and do not need to be altered (except perhaps to give deemed trusts under provincial pension legislation the same effect as the deemed trust has under the *Pension Benefits Standards Act, 1985* (Canada)).

If the Government does see a need to strengthen the current legislative provisions designed to provide benefit security to members of defined benefit pension plans, there are a number of other options that would protect pension benefits and ensure the financial strength of plan sponsors that should also be carefully considered. Some of these options include:

- The statutory deemed trust could be extended to include unpaid wind-up deficit amortization payments (as presently contemplated by Bill C-9). This would give protection over part of the Unfunded Pension Plan Liabilities.

- A distressed pension plan workout scheme to facilitate a negotiated funding arrangement would protect both the business enterprise and pension benefits of employees (as presently contemplated by Bill C-9).

- Advancement of the reform proposals to allow plan sponsors to fund solvency special payments with letters of credit (as presently contemplated by Bill C-9) that will preserve company cash flow thereby strengthening financial position and still contribute to improved benefit security for plan members.

- Advancement of the reform proposals to require annual actuarial valuations (as presently contemplated by Bill C-9).

- Finally, a scheme that would protect pension fund assets by permitting a government agency or some other entity to administer distressed pension plans (e.g., as enacted in Quebec).

We respectfully urge you to carefully consider the effect of this legislation on plan sponsors and the Canadian retirement system in light of this information. We would be pleased to discuss our comments further as you may require.

Sincerely,

Bryan D. Hocking
Chief Executive Officer