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Canadian Association of Insolvency and Restructuring Professionals
Association canadienne des professionnels de l'insolvabilité et de la réorganisation

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Re: Consultation Document – Enhancing Retirement Security for Canadians

Mr. Schaan,

We are writing in response to your request for a comment from the Canadian Association of Insolvency & Restructuring Professionals (**CAIRP**) concerning the consultation document *Enhancing Retirement Security for Canadians*.

CAIRP represents over 980 insolvency professionals and over 500 articling, life and corporate associates. About 90% of Licensed Insolvency Trustees, licensed under Canada's Bankruptcy and Insolvency Act, are members of CAIRP.

This paper focuses much of its commentary on the insolvency related options identified in the consultation document.[1] However, considering the importance of retirement security to all Canadians and the fact that relatively few retired individuals are adversely affected by insolvent employers with defined benefit plans, we are also providing high-level suggestions in support of Canada's broader retirement income system (**RIS**). We believe smart and creative improvements to Canada's RIS can positively impact the retirement years of all Canadians, while also supporting the ongoing growth of Canada's economy.

Based on workforce statistics published by Statistics Canada, the 1.2 million Canadian private sector workers whose employers offer a defined benefit (**DB**) plan would represent about 10% of all private sector workers and 8% of all workers in Canada. Existing pension and insolvency legislation provide some protection for DB pension plans and most private sector employers who offer DB plans are financially stable. The reality is there are relatively few Canadians at significant risk of

[1] We point out that several of the issues raised in the Consultation Document have already been addressed by CAIRP in a submission made in connection with proposed Bills C-476, C-487, C-501, S-214 and S-216 (40th Parliament) in June 2010. The issues raised in this submission are still relevant. A copy of the submissions can be provided to you upon request.

their retirement years being adversely impacted by insolvent employers who cannot fulfill most or all of their pension obligations. With that said, all Canadians deserve a financially secure retirement. We agree that the few at risk of losing their DB pension should be appropriately protected, provided such protections do not create conditions that risk the greater good of all Canadians, including those the protections are intended to support.

The greater risks to the retirement security of Canadians is insufficient income throughout their retirement years and as well, unsustainable discretionary spending habits that many practice. Evidenced by the steadily rising percentage of Canadian seniors living in poverty (12.5%). As further evidence, both the absolute number (2017 – 13,686 vs. 2012 - 10,911) and relative percentage (2017 – 11.20% vs 2012 – 9.20%) of insolvency filings for Canadians over the age of 65 have risen sharply in recent years. In a recent member survey conducted by the CAIRP, members identified poor financial literacy as the most significant contributor to unhealthy levels of consumer debt amongst seniors. Insufficient income was noted as another significant factor.

Insolvency Legislation

- **Ensure unfunded pension liabilities and terminated employee benefits are paid ahead of the claims of secured creditors**

  As CAIRP explained in its June 25, 2010 Submission on a Review of Bill C-476, C-501, S-214 and S-216 (40th Parliament), assigning “super-priority” status to any unfunded pension liabilities of DB plans risks a severe contraction of credit for all borrowers who offer DB plans. If pension plans were provided “super-priority” status, the uncertainty of being able to accurately determine the existence or magnitude of a pension funding deficit and the time lag in obtaining current actuarial valuations would motivate lenders to raise the cost of borrowing and/or reduce credit limits. Providing a “super-priority” status could lead to a variety of unintended consequences, such as impairing a corporation’s growth investment opportunities, or triggering an insolvency within companies who are otherwise “surviving” or impeding the ability for employers to make further contributions to pension plans.

  It is important to note that the value of a pension plan deficit can fluctuate significantly during the time of insolvency proceeding, making it a challenge to determine values on a timely basis accurately. Considering that insolvency and restructuring involves to a great extent the allocation of scarce resources amongst stakeholders, the changing values while the restructuring progresses makes the negotiation of a compromise difficult or impossible if the unfunded pension deficit is granted super-priority status, which is counterproductive to the remedial objectives of the *Bankruptcy and Insolvency Act*[2] (**BIA**) and the *Companies’ Creditors Arrangement Act*[3] (**CCAA**).

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

[3] *Companies’ Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended.

Furthermore, it should be noted that the "super-priority" status of pension plans could give a false illusion of protection in circumstances where an insolvent company's assets are insufficient to cover the costs of a pension deficit.

Consideration should be given to further studying the opportunity to preserve the rights of employee claims to employee benefits (e.g. life insurance, LTD, health, etc.) during insolvency proceedings. Employees are the most vulnerable stakeholder in insolvency, dependent on the employer as their principal source of income and with limited means to protect themselves against financial loss. However, an appropriate balance must be achieved in any protectionist policy, considering issues similar to the ones discussed above for unfunded pension liabilities. Granting protections for employee benefits can lead to unintended consequences, which may include triggering insolvency or adversely impacting the employer's economic performance. An employer's exposure for employee benefits can be estimated at any point in time, but it is impossible to predict how the costs of employee benefits will change with time. This uncertainty of exposure will lead to the contraction of, or higher costs of, credit.

As well, CAIRP expects that legislating a super-priority for unfunded pension plan liabilities and other employee benefits could have a significant adverse impact on the possibility of obtaining interim financing to carry out a restructuring process, which would also be counterproductive to the remedial objectives of the BIA and CCAA.

CAIRP has significant concerns regarding the impact on credit availability of any super-priority measure and as such believes a comprehensive consultation process should be undertaken to assess the expected impact before legislating added protections for pension liabilities and terminated employee benefits, where the protections may result in additional statutorily secured charges against the assets of an insolvent company.

Pension Options

- **Solvency Reserve Accounts**

  Providing employers with an option to set up a Solvency Reserve Account (**SRA**) is a measure that may be perceived by some employers as a lower risk means to top up a pension fund deficit. An SRA would provide some level of comfort, knowing they can pull out excess monies in the event their actuaries later determine they overestimated the deficit or where the fund achieves better than anticipated returns in a future period. However, unless employers are required to use an SRA account, in circumstances where a recalculation shows a deficit, the risk of over-contributing may discourage many managers to make such payments voluntarily. The reality is that pension deficits are most often triggered by cash flow shortages when companies experience financial hardship. Availability of an SRA would likely not be of value in this situation.

- **Pension funding relief criteria**

  Pension funding relief measures would appear to be a worthwhile endeavour in circumstances where the pension plan problems are considered to be temporary because of a cyclical downturn in the value of the portfolio, or a punctual cash flow difficulty of the plan sponsor. Much consideration has to be given to the viability of the pension plan, however as pension funding relief measures could be a slippery slope, in particular, if the measures involve a suspension of contributions rather than an extension of the period over which a deficit may be amortized.

  Pension funding relief measures may have merit if an insolvency process can be averted or to help a company exit an insolvency restructuring process faster. In that context, we consider that if pension relief measures are intended to help an employer through financial difficulties, it is reasonable to expect that some restrictions be imposed on the employer's activities, as a *quid pro quo*. We consider however that it would be important for such restrictions to 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 which would be counterproductive.

- **Transfers to self-managed accounts**

  This strategy would crystalize the retirement capital of employees at a point in time (which depending on the state of equity markets) may, or may not, be to the employee's advantage. In any event, such a transfer would place the risk of investment performance directly on employees who may, or may not, possess the financial literacy competency to maintain and grow their retirement capital. In an effort to reduce this risk, the government could consider establishing programs that provide affected employees access to quality financial planning services and education.

- **Clarify benefit entitlement**

  If existing legislation intends that members of DB plans shall be entitled to their accrued pension benefits, but the legislation is not explicitly clear to that intent, then it makes sense that the legislation should be amended for clarity. However, in the event of an insolvency filing, such clarity won't solve a pension deficiency if the employer doesn't have sufficient resources to cover it or if other secured creditors have priority over the existing resources. Further, if legislation forces a "surviving" employer to allocate more resources to fund its pension plan, that requirement itself may force the employer into an insolvent position, negatively impacting both current employees and possibly as well, retired employees receiving pension benefits. Forcing continuing payment of full pensions without addressing the deficit problem may also create a shift the balance of plan value from current employees towards retirees.

Corporate Governance Options

- **Restrictions on corporate behaviour; Increased corporate reporting and disclosure requirements**

  The risks associated with placing restrictions on corporate behaviour should be carefully considered before taking any legislative action in this respect. Limiting the payment of dividends or share redemptions or increases to staff executive and Board director compensation can influence corporate leaders to consider decisions that may not be in the corporation's best interests. For example, such limitations may encourage the resignation of key executive members at the outset of financial challenges and/or hinder the ability for insolvent companies to recruit replacement directors. The cost of, or accessibility to, directors and officers liability insurance may also become unaffordable or unattainable. Companies may also be encouraged to jurisdiction shop, incorporating provincially to avoid the federal requirements.

  With the above in mind, it is important to point out that corporate leaders should be accountable for corporate performance. Even in circumstances where performance is largely out of their control, leaders are expected to have the vision to plan for a wide range of contingencies and avert financial challenges. Corporate leaders are normally well rewarded for strong corporate performance and arguably, should be accountable for poor performance. As such, it seems reasonable to consider appropriate restrictions or incentives on corporate behaviour – however, finding the right policy balance between encouraging accountability and discouraging an exodus of key personnel is the challenge.

  It makes sense that corporations should be required to report transparently on all matters that may affect their employees' and retirees' pension fund. Greater transparency measures would provide workers and shareholders alike the information to more accurately assess a corporation's performance from both an employer and investor perspective.

Insolvency Options

- **Enhanced "look-back" period**

  There is some attractiveness to implementing measures that discourage bad behaviour. If such a solution could be designed to specifically penalize corporate leaders who demonstrate poor or negligent behaviour, it could have the dual effect of encouraging poor performers to leave their positions sooner, while also clawing back monies to help reduce a pension deficit. Further, there may be some value in trying to implement policies that claw back excessive bonuses or compensation increases.

However, in dealing with such a measure, there is an implicit challenge in assessing what would be considered "excessive".

As well, the contemplated measure might carry significant risks, as follows:

- The risk of losing a bonus and/or compensation increase creates an incentive for key executives to flee a corporation at the first signs of financial stress.
- This solution may unfairly penalize leaders for the corporate performance they may have had little or no control over.
- "Look-back" provisions might also encourage more executives and directors to accelerate the shift from offering a DB to a DC plan.

- **Enhanced transparency in the CCAA process and obligation to act in good faith**

Insolvency proceedings should be fair to all stakeholders. Accordingly, measures that promote the transparent sharing of relevant information can only support the negotiation of a fair and reasonable compromise solution that serves all parties interests. While increased transparency itself will not prevent an insolvency or fix a pension deficit, it can support a better end result, and as such suggestions that seek to improve transparency, good faith and efficiency in the insolvency system are always worth exploring.

We point out that CAIRP has already expressed comments on measures intended to improve transparency and the exercise of good faith, through the submission of the Joint Task Force formed by the Insolvency Institute of Canada (**IIC**) and CAIRP on the statutory review of the BIA and CCAA in the Summer of 2014.[4] CAIRP's views in this regard have not changed and those comments are still relevant today, and we invite you to refer to them. In particular (but without limiting the scope and breadth of the comments made in the 2014 submission), while CAIRP believes that measures to improve transparency and promote good faith are a worthwhile endeavour, CAIRP cautions that 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 process could be managed in Québec and the rest of Canada. 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 noted that while measures are worthy of exploration, due consideration has to be given to the inherent difficulties that would exist in implementing such measures. Assessing the degree to which a party may be lacking on transparency or the exercise of good

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[4] Report on the Statutory Review of the *Bankruptcy and Insolvency Act* (**BIA**) and the *Companies' Creditors Arrangement Act* (**CCAA**) To Industry Canada, sent on July 15, 2014, addressed to Paul Halucha. A copy of the submission can be provided upon request.

faith may be akin to "proving a negative". For a measure to be effective, due consideration has to be given as to how the conduct of the participants will be gauged and monitored, and what sanctions can be applied if the participant's conduct is found to fall below the expected standard.

Suggestions to improve the RIS

- **Educate retired and near retired consumers**

  Step up the government's strategy and investment in the financial literacy education to better ensure seniors possess the financial competencies to appropriately invest their portfolio of savings and spend within their means.

- **Enhance the income levels of all seniors**

  - Consider increasing the employer/employee contributions to CPP/QPP to raise the CPP/QPP post-retirement income.

  - Compel/motivate all employers to implement an employee retirement plan that includes an employer contribution directly to their employees' RRSP.

  - Raise the annual limits for RRSP contributions to accommodate higher employer and employee contributions.

- **Safeguard retirement portfolios**

  Motivate Canadians to better safeguard their RRSP investment portfolio by encouraging lower risk investments, particularly as they near retirement. This could be accomplished by requiring self-administered RRSP accounts to benefit from a wide range of easy to understand investment decisions; decreasing the cost of administration of the investment accounts to alleviate the need to increase yields through speculative investments; and provide a varying scale for the taxation of withdrawals, depending on whether the withdrawal comes from the invested capital, from a yield considered as a conservative or safe investment, or from a yield considered as more speculative in nature. For example, provide incentives for RRSP portfolios to be more heavily weighted with lower risk financial instruments such as bonds, GICs, and preferred shares by taxing the withdrawal of interest and dividend income at lower rates.

- **Consistent Legislation**

  The federal government should work more closely with the provincial governments to harmonize pension and insolvency related legislations to best practices. This should reduce jurisdiction shopping by minimizing the opportunity of avoiding public interest measures by incorporating in another province or federally vs. provincially. Further, it will simplify the business framework for Canada's trading partners.

It should be noted that while some of these RIS recommendations come with a related cost, the net value of each should be positive. Consider that encouraging RRSP portfolios to reduce their exposure to higher risk stocks may have a slightly negative impact on access to growth capital for Canadian business. Further, raising RRSP limits and reducing tax rates on interest and dividend income held in RRSP portfolios will reduce government tax revenues. However, more than offsetting all these costs will be the benefits of greater consumer spending capacity and fewer insolvency filings from a growing segment of Canada's population (retirees) – fueling long-term healthy business and tax revenue growth across Canada.

As final comments, while CAIRP is confident in the high-level positions presented in this paper, we encourage the government to conduct further research to provide empirical evidence that can help accurately map out and evaluate the proposed options. Further, note that we have structured some of the recommendations to encourage policies that "nudge" positive responses as opposed to force paternalistic decisions – which we believe can support better outcomes.

Thank you for the opportunity to comment on this initiative and please feel free to contact me if CAIRP can be of any further assistance.

Sincerely,

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