

Introduction

Canada is an international laggard in its treatment of pensioners. Many countries protect pensioners from the fallout of financially distressed employers. The EU requires member governments to "necessary measures" to protect the interests of employees with respect to pension rightsⁱ. U.S. jurisdictions protect pensioners' assets – up to \$64,000 per yearⁱⁱ. A special fund in the U.K. guarantees pensioners 90 percent of their pensionsⁱⁱⁱ. In Canada, there is no federal pension protection. Only in Ontario are some private pension plans protected, and that protection is only on the first \$12,000 annually^{iv}.

Corporate defined benefit pension plans are underfunded by billions of dollars, putting 1.3 million Canadian pensioners at risk.

There are two historical precedents for protecting pensioners by giving them priority ahead of secured creditors, known as super-priority, in the event of bankruptcy or insolvency. CARP is calling for legislation to give all unfunded pension liabilities super-priority.

Background

Secured creditors such as bankers and bondholders take precedence over corporate pensioners under Canadian federal bankruptcy laws. When companies enter into bankruptcy or insolvency, pension fund deficits are treated as unsecured debt and have little likelihood of being paid. Without sufficient funds to pay them, promised pension payments for pensioners are cut.

The consequences of these cuts can be catastrophic and widespread. Pensions are often retirees' primary assets; without an employer pension, the vast majority of Canadians have inadequate retirement savings^v. Pensioners who have less financial security in retirement are more likely to require government support, forcing taxpayers to pick up the additional costs for public social security programs.

A corporate defined benefit pension plan is one where a company promises to pay out a set amount, typically a percentage of an employee's average salary over a set period, for the life of the employee. There may also be a provision to pay a percentage of the pension to a surviving spouse. While amounts paid into the plan by employees and companies are protected, many companies have underestimated the total cost of their pension obligations, leaving corporate defined benefit pension plans underfunded.

Corporate defined benefit plans are at risk for two reasons. First, companies are only required to fund pension shortfalls over extended periods, typically five or even ten years. This results in significant unfunded pension liabilities. Second, when companies go

bankrupt, pensioners are treated as unsecured creditors, so assets available go to secured creditors rather than pensioners.

To date, tens of thousands of pensioners across Canada have had their pensions cut:

- Nortel Canada filed for bankruptcy in 2009 with unfunded pension liabilities of over \$2.5 billion, resulting in 12,000 employees facing pension cuts of up to 40 per cent.
- Wabush Mines filed for bankruptcy in 2015 with a \$30 million pension plan deficit. As a result, 700 former employees face pension cuts of 20 to 25 per cent.
- Over 10,000 employees of Indalex, Algoma, Grant Forest Products and others have had their pensions cut with no recourse under existing laws.

Most recently, Sears Canada (Sears) joined the list of distressed companies. Sears' pension plan is underfunded by more than \$250 million, putting the retirement security of over 16,000 pensioners at risk. Sears' pensioners face cuts of 20 per cent to their pension payments. The situation with Sears is particularly egregious as it comes after years of sell-offs, with shareholders receiving over one billion in dividends while Sears deliberately liquidated its saleable assets^{vi}.

Corporations must be held accountable for their obligations to former employees.

What About the Bond Market?

The concept of super-priority for pensioners in corporate defined benefit plans has been debated for years in Canada. Opposition to super-priority centres on fears of a material, negative impact on the bond market^{vii}. But is this the case?

Academic and independent financial analyst Diane A. Urquhart believes any net impact after considering the cost to governments for increased use of social programs would be nominal. (A summary of her arguments as well as references to her complete analysis is included as Appendix A).

Former wealth management firm Philips Hager & North Investment Management Ltd. (PHN) estimated the impact of super-priority to pensioners to be \$22 billion, with an impact on credit markets of .29% or 29 basis points. (A summary of their arguments as well as references to their complete analysis is included in Appendix A, as is a final rebuttal).

With such differences in predicted outcomes, deciding who to believe is a critical question. Fortunately, we need not rely on academic forecasts and industry conjecture but can look at what has actually happened to the bond market when changes to grant pensioners super-priority have occurred in the past.

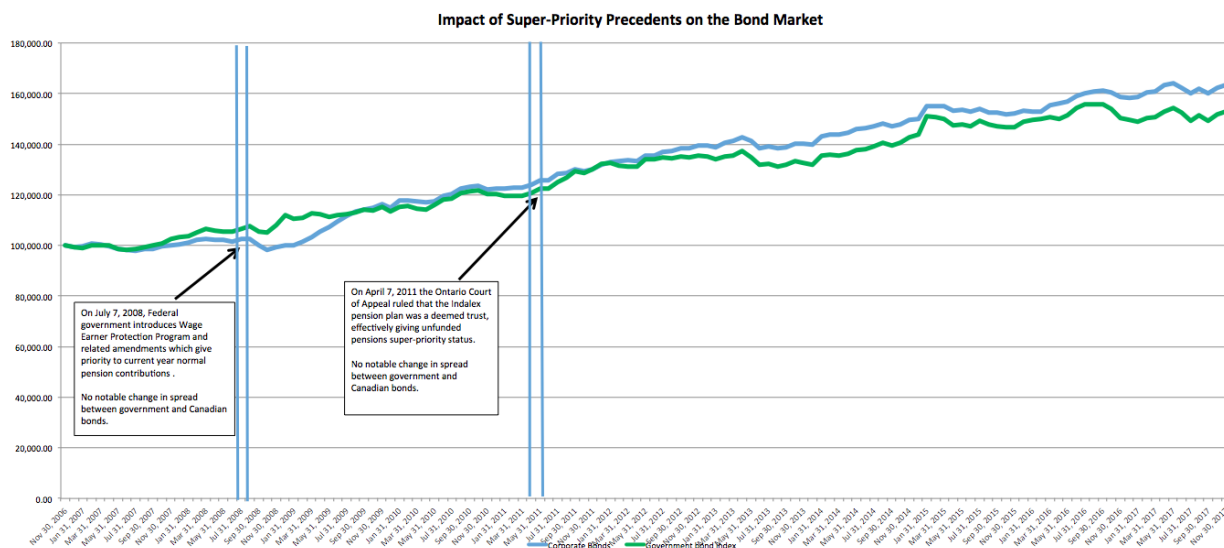
Super-priority for Pensioners: An Impact Assessment and Policy Prescription



As a proxy for corporate bond prices, we have used BlackRock iShares indices XCB and XGB which track Canadian corporate and government bonds respectively. The graph below shows the index since its inception in November of 2006. The graph reflects the value of a \$100,000 investment over time. An increase in the index reflects either lower interest rates (prices rise to reflect a drop in yield) or increased risks (prices rise to reflect a demand for a higher premium).

We can isolate the effect of interest rates by comparing to movement in the Canadian government bond index. Any differences in movement between the two indexes highlight changes which would only impact corporate bonds (like super-priority status for pensioners).

The graph below shows the BlackRock [Canadian Corporate Bond Index](#) (XCB) together with the Black Rock [Canadian Government Bond Index](#) (XGB) as comparison. (Also included full-size as Appendix B.)



Legislative precedent shows minimal impact

On July 7, 2008, the Wage Earner Protection Program (WEPP) came into force, together with complimentary amendments to the Bankruptcy and Insolvency Act (BIA), which granted super-priority status to current year pension contributions for normal cost amounts (the amounts required to be paid in a given year to fund benefits).

As for the legislative change, a picture of the bond market yield curve for 2008 shows no significant increase on or after July 7 (See above, or Appendix B).

These amendments represent a critical historical precedent. Laws to put pensioners first have not materially impacted bond markets in the past.

Court precedent shows minimal impact

Indalex Canada (Indalex) sponsored and administered two registered pension plans which became insolvent; the company sought protection from creditors. In 2011, the Ontario Court of Appeal gave pensioners super-priority over other outstanding secured creditor claims^{viii}. This legal precedent held for nearly two years until being overturned by the Supreme Court of Canada in 2013.

As for the judicial change, a picture of the bond market when this judicial precedent was announced shows no undue unrest (See above, or Appendix B).

CARP Members Call for Action

CARP members surveyed are strongly in favour of super-priority status for pensioners in the event of a bankruptcy or restructuring. A recent poll revealed support of 83% with 4% opposed and 13% neutral.

Together with partners LeadNow and the Canadian Federation of Pensions, our petition and "e-mail your MP" campaigns garnered 50,000 signatures and emails to MPs. Pension protection is an issue that resonates with our members.

It's time for Pension Protection

CARP is calling for legislative changes to give pensioners "super-priority" status in the event of a bankruptcy or restructuring. Pensioners can least afford a financial hit so must rank ahead of all creditors when it comes to distributing available funds in a bankruptcy. Two Federal insolvency statutes must be amended: the Bankruptcy and Insolvency Act; and, the Companies' Creditors Arrangement Act.

Canadians who earn promised pensions over years and decades depend on that income in retirement. If the payments stop, their quality of life is at stake. Corporations should not be allowed to shirk their responsibilities to pensioners or offload them to taxpayers.

ⁱ "Ros Altmann: How the EU Has Protected Our Pensions." *Money Marketing*, 9 June 2016, www.moneymarketing.co.uk/ros-altmann-2/.

ⁱⁱ "Pension Benefit Guaranty Corporation A U.S. Government Agency." 7 December 2017. <https://www.pb.gc.gov/about-pbgc/who-we-are/retirement-matters/best-saved-plans>.

ⁱⁱⁱ "What is the Pension Protection Fund... and what do we do?" *Pension Protection Fund*. http://www.pensionprotectionfund.org.uk/DocumentLibrary/Documents/What_is_the_ppf.pdf.

^{iv} "Pension Benefits Guarantee Fund (PBGf)." *Financial Services Commission of Ontario*. <https://www.fsc.gov.on.ca/en/pensions/pbgf/Pages/default.aspx>.

^v Less than 30% of Canadian seniors without employer pensions have 5 years' worth of replacement income saved.

Richard Shillington. "We're Facing a Wave of Seniors Living in Poverty - and We're Not Ready." *IPolitics*, 17 Feb. 2016, ipolitics.ca/2016/02/17/were-facing-a-wave-of-seniors-living-in-poverty-and-were-not-ready/.

^{vi} Sophia Harris. "Who killed Sears question sparks bitter blame game among top players." *CBC News*. 27 Oct, 2017, <http://www.cbc.ca/news/business/sears-canada-eddie-lampert-brandon-stranzl-1.4367985>.

^{vii} Phillips, Hager & North Investment Management Ltd. "Bill C-501: Analysis of Potential Impact on Canadian Credit Markets submitted by Phillips, Hager & North Investment Management Ltd." https://ismymoneysafe.org/pdf/PH&NSubmissionBillC-501_ENG.pdf.

^{viii} On April 7, 2011, the Ontario Court of Appeal held that where a pension plan is wound up, the entire pension plan deficit owed by the employer under the Ontario Pension Benefits Act (PBA) is subject to deemed trust provisions. This meant that a deemed trust had priority over other outstanding secured creditor claims, including debtor-in-possession (DIP) charges.

Borden Ladner Gervais LLP -Michael MacNaughton and Craig J. Hill. "The Ontario Court of Appeal's decision in re. Indalex Limited...." *Lexology*, www.lexology.com/library/detail.aspx?g=26c6828c-02b4-492b-aedc-c5cb483d7529.

Appendix A – Academic and Industry Analysis

The Academic Case for Super-Priority

Diane A. Urquhart is an independent financial analyst who has studied the capital markets for many years.

In her report entitled [*Interventions to Protect Nortel's Canada Estate for Canadians*](#), she argues that the overall impact of granting preferred status to unfunded pension liabilities on the cost and availability of credit is nominal. According to Ms. Urquhart's analysis, the estimated impact on the cost of credit is in the range of less than 0.05% to .26% annually^{ix}.

She explains:

"...the % of investment grade corporate bonds that enter liquidation is very small; the % of corporations that have defined benefit pension funds is only about one third in Canada; only a portion of pension plans should be in deficit at the same time that the corporations are liquidating due to government pension regulations; and, the average realized loss for unsecured creditors in bankruptcy is already very high and so the additional loss for unsecured creditors that arises due to pension fund deficits and severance being at preferred status is incrementally modest."

Urquhart further argues in a separate report entitled *Induced Bankruptcies Cost Canadian Taxpayers Billions of Dollars Federal Government Not Stopping the Abuse*, that the cost of additional social security program expenditures and reduced income tax revenues from companies neglecting their responsibilities to employees is in the billions^x.

The Industry Case for Rejecting Super-Priority

Philips Hager & North Investment Management Ltd. (PHN), a high net worth investment firm, reached a different conclusion, estimating the impact of this change to be \$22 billion, with an impact on credit markets of 29 basis points.

Their study entitled *Bill C-501: Analysis of Potential Impact on Canadian Credit Markets*, argued that the impact of preferred creditor status to unfunded pension obligations would be potentially broad and significant. They held that creditors would be less willing to lend, particularly when credit is needed most, due to the potentially increased risk of receiving a lower recovery value. Finally, they disputed Ms. Urquhart's claim that the impact on the credit market would be minimal, and concluded that the cost to existing bondholders and

Appendix A – Academic and Industry Analysis

corporations is likely as high as \$22 billion, with an impact on credit markets of 29 basis points^{xi}.

[Their full study can be read here.](#)

Concerns about the Industry's Analysis and Rejection of Super Priority

PHN has, at minimum, the appearance of a conflict of interest in their government recommendations. Prior to issuing this study, they had made a broad recommendation to investors to purchase lower-grade corporate bonds. [It can be read here](#)^{xii}.

The PHN study selectively picked companies to include in their analysis (all major banks were excluded). At minimum, that makes it difficult to apply their conclusions to the Canadian corporate market, which is dominated by the major banks.

Finally, they failed to consider market reaction to pension protection legislation. Given their increased exposure, bondholders and bankers are likely to demand companies fund pension liabilities in preference to dividends and executive bonuses. This would leave their security untouched and provide full protection to pensioners.

^{ix} Diane A. Urquhart. "Induced Bankruptcies Cost Canadian Taxpayers Billions of Dollars Federal Government Not Stopping the Abuses." November 19, 2009.
<https://ismymoneysafe.org/pdf/InducedBankruptciesCostCanadianTaxpayersBillionsofDollars11192009.pdf>

^x Diane A. Urquhart. "Interventions to Protect Nortel's Canada Estate for Canadians." July 6, 2009.

^{xi} Phillips, Hager & North Investment Management Ltd. "Bill C-501: Analysis of Potential Impact on Canadian Credit Markets submitted by Phillips, Hager & North Investment Management Ltd."

^{xii} Phillips, Hager & North Investment Management Ltd. "Corporate Bond Market Trends: BBB Rated Bonds Gaining Importance. January 6, 2016.

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Appendix B – Impact of Super-Priority Precedents on the Bond Market

