CFP Responds to the Myths about Pension Protection

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That pensioners should receive 100% of the pension their employer committed to is well accepted. Pensioners should not face a lifetime of financial hardship should their former employer file for insolvency. Vulnerable seniors should not be treated as acceptable collateral damage in insolvency.

There are many ways to protect pensions in insolvency. The vast majority of these solutions require no taxpayer dollars; just government's will to change legislation.

Proposals to protect pensions in insolvency have been debated for decades. Over that time arguments against pension protection have been made and largely accepted without challenge. These arguments have been around so long that they have become accepted as fact. They are not.

In fact, none of these arguments stand up to scrutiny.

Presented here is the evidence that these long held facts are actually myths.

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Canadian Federation of Pensioners

The Canadian Federation of Pensioners (CFP) advocates on behalf of defined benefit pension plans and their members. Founded in 2005, the CFP is the united voice of 23 retiree groups, representing over 300,000 defined benefit pensioners, who work together to improve pension security across Canada. CFP works closely with organizations such as the National Pensioners Federation, CanAge, CARP and FADOQ on pension issues

Our organization has a long history of working collaboratively with provincial and federal government agencies responsible for pension regulation. Our active engagement at the federal and provincial levels includes pre-budget consultations, committee hearings, legislative consultations, stakeholder meetings, lobby days, media campaigns and face-to-face meetings with senior ministers and other elected and government officials.

What is a Defined Benefit Pension?

- Over 4 million Canadian retirees and their spouses rely on defined benefit pension plans.
- A defined benefit pension plan is part of an employee’s total compensation. The contribution comes from the employee as a direct contribution or from the employer in lieu of other forms of compensation or a combination of the two. For example, a union might forgo some wage increases to obtain an agreement that the company would fund the pension.
- A defined benefit pension is legally considered deferred wages that are earned while an employee is working and collected when they retire.
- The annual pension amount is calculated using a formula that reflects an employee’s salary, length of service and age.
- Pensioners have planned their retirement based on their defined pension income.
- Pension income is taxable in the hands of pensioners.

Understanding the Pension Regulatory Framework

The pension regulatory framework in Canada is very complex. Canada has two tiers of legislation that directly impact pension security. Eleven different jurisdictions are responsible for pension legislation and regulation. Federal insolvency legislation enjoys paramountcy over pension regulations. In the event of a conflict, the federal insolvency legislation supersedes other pension-related legislation. In addition, pension security is impacted by business regulations and tax codes in 11 different jurisdictions.

While a company is operating as a going concern the risk to pensioners is a future possibility. The possibility of a pension crisis becomes a reality when companies file for insolvency under federal jurisdiction.

What Happens to Pensions When a Company Becomes Insolvent?

When companies file for insolvency, the pension unfunded liability becomes an unsecured obligation and becomes one of the lowest priorities to be settled. This, despite the fact that in a number of provinces, the pension unfunded liability is a deemed trust with the highest priority of settlement. Insolvency legislation holds paramountcy over pension regulations and as it does not explicitly define the pension unfunded liability as a deemed trust, companies and their creditors are shielded.

The Canadian Federation of Pensioners Three Tenets

1. Pensions are deferred wages. They are earned while working, payable after retirement.
2. Pensioners deserve the pension their former employer committed to.
3. The responsibility to ensure pension protection falls on government. Government has not provided pensioners any control, input or approval of changes to their pensions. Government has reserved this power to itself.

CFP is solution agnostic. We have made several proposals to all levels of government to provide full protections for pensions. They can be found on our website www.pensioners.ca.

Arguments

Super-priority for pension liabilities will lead to credit restrictions and insolvencies

Argument: Super-priority for unfunded pension liabilities ultimately has the potential to harm the pensioners it seeks to help. It will put at risk the ability of companies to raise capital, leading to more insolvencies.

CFP Reality Check: There is no evidence that extending super-priority to the unfunded pension liability would lead to credit restrictions or an increase in liquidations.

There is, in fact, evidence to the contrary.

Similar claims were made by government bureaucracy and the finance industry when the Wage Earner Protection Program was debated (WEPP would extend super-priority to wages earned but not paid in an insolvency, to a maximum of $2,000 per individual).

It was claimed that the super-priority status of unpaid earnings would result in credit restrictions on companies, particularly on access to secured financing. The government of the time was warned that implementation of WEPP would result in a significant increase in insolvencies.

The wave of insolvencies did not occur following the 2008/9 implementation of the Wage Earner Protection Program.

The same fears about credit restrictions and increase in liquidations didn't happen after the April 7, 2011 Court of Appeal for Ontario ruling, in the Indalex case. The court ruled pension deficits were a deemed trust; a priority in insolvency right at the top, above other claims including super-priority.

At the time, comments from the financial and legal communities were similar to this from Stikeman Elliott:

Unless overturned, it will almost certainly have a significant negative impact on the availability of asset backed loans for entities with defined benefit pension plans given that it conferred priority over secured creditors (including the creditor subordinated to the rights of the super-priority DIP lender) for unfunded employer liabilities to the company's defined benefit pension plans.

This ruling stood in Canada for two years until, in a complex ruling that is still being debated and litigated, the Supreme Court of Canada overruled the decision.

The fact that the ruling was overturned is irrelevant. If the threat of increasing pension priority was so dire, where was the impact? There was no tsunami of insolvencies. Stakeholders made accommodations and business continued.

If super-priority was in place previous successful restructuring deals would have failed

Argument: Previous successful restructurings, Stelco for example, would have failed if the new owner had to deal with the pension deficit.

CFP Reality Check: The fundamental assumption here is that corporate behavior is immutable. That the company would make the same decisions regardless of changes in the regulatory environment.

Clearly, this is false logic. If true, no progress would ever be made. If the test of 2050 emissions standards was the impact if they were imposed today, they would never happen.

The Air Canada history is that a change in the rules lead to a change in corporate behaviour and elimination of the pension deficit.

Large pension deficits are beyond the control of the company

Argument: Large pension deficits occur due to events beyond the company's control. The company does not have the cash flow to fully fund the pension.

CFP Reality Check: There is no evidence to support this and much counter evidence.

This argument is based on the premise that the company has experienced a liquidity problem so severe that it was not possible to achieve 100% solvency funding.

Yet there are many examples where pensions were allowed to fall below, in many cases well below, 100% solvency funding while other discretionary expenditures continued. It is well documented that companies that failed continued to pay dividends, buy back shares, pay executive bonuses, etc. while pension underfunding existed and increased.

Studies, including the Canadian Centre for Policy Alternates "The Lions' Share", illustrate that the vast majority of companies pay out substantially more in dividends, share buy backs, executive bonuses, etc. than would be required to fund their pensions.

Federally regulated pensions are required to be 100% solvency funded

Argument: Federally regulated defined benefit pension plans are already required to be funded at 100% with any shortfall paid by the employer within five years, unlike those regulated by some provinces which allow for greater levels of unfunded pension liability.

CFP Reality Check: This attempt to simplify the explanation has led many to believe federally regulated pensions must be 100% funded on a solvency basis and must be fully funded within five years of a pension deficit. Neither is fully accurate.

There is no requirement that federally regulated pensions be 100% funded at any particular point in time. Instead, 100% solvency funding is just a target which is used to calculate the pension contribution for the following year.

But many variables, over which a company has control, go into making that pension contribution calculation. This discretion results in many companies underfunding their pension.

If they miss the target, there is no penalty applied to the company. Rather, the have the option to pay back the difference over five years. That does not mean the pension is required to be fully funded within five years of this deficit. A pension contribution deficit in year one triggers a calculation to spread payments over five years. A deficit in year

two initiates a new calculation over a five year time period, it is now six years. And so on. This is the domino effect and the shortfall and time to repay keeps growing

If a company becomes insolvent during this time, the underfunding is never addressed and pensioners bear the loss.

The government has made these rules, which benefit companies at the expense of pensioners. This legal loophole puts pension security at risk.

The result of this process is that today, over half of federally regulated pensions are less than 100% solvency funded. Over half of federally regulated pensions have been less than 100% solvency funded each year for the past ten years.

There are no penalties for errors, no penalties for creating pension deficits. Those that do simply enter the five-year+ payback scheme as described above.

It is important to note that when many well-known insolvencies of provincially regulated pensions occurred (such as Nortel, Sears, Cliffs Natural Resources, etc.) they were under the same 100% solvency "requirement" as current federally regulated pensions. This false requirement clearly doesn't do anything to protect pensioners.

It is also important to note that while some provinces have reduced solvency requirements, there are key provincial backstops that the federal government refuses to acknowledge in federal legislation.

For example, in Ontario the pension deficit is a deemed trust, first in line for settlement before super-priority. This was why the Indalex case went to the Supreme Court of Canada. That court acknowledged the validity of the deemed trust under Ontario law, but when there is an insolvency filing federal law takes precedence, and there is no equivalent deemed trust in the CCAA or BIA. It is federal legislation that failed, abandoning seniors in the Indalex case. If federal legislation preserved the Ontario deemed trust provision the pensioners of Indalex, Sears retirees, for example, would have been protected.

Pension protection should be addressed further upstream in pension regulations, not in insolvency

Argument: If we could prevent underfunding of pensions in the first place, this problem could be avoided. This is the real solution to protect the pension benefits of workers.

CFP Reality Check: There is merit to this approach, however there are two significant hurdles to overcome and a hard reality to acknowledge.

No jurisdiction in Canada requires 100% solvency funding. Even in jurisdictions where the target solvency is 100% (like the federally regulated pensions) over 50% of pensions are less than 100% funded at any point in time. This does not ensure pensioners receive 100% of their pension in insolvency.

There are multiple pension jurisdictions in Canada. It would take significant leadership from the federal government to accomplish this. CFP has long asked for a federally lead initiative to do just this. To date the federal government has not offered to do so.

The reality in Canada is that pensioners receive 100% of the pensions promised them until their former employer files for insolvency. They are protected until they enter federal jurisdiction where a theoretical problem becomes real.

No other OECD country treats pension deficits in insolvency as super-priority

Argument: None of the OECD countries have implemented super-priority because of the unintended adverse effects it would have on the workers we all aim to better protect.

CFP Reality Check: It is true no other OECD countries have implemented super-priority. Yet it is recognized that other OECD countries provide significantly superior pension protection for their seniors.

If the Canadian government is aware of these superior solutions, why has the government not implemented them? Why has the Canadian government not proposed a single credible solution that would fully protect pensions in insolvency?

The successful 2004 Air Canada restructuring demonstrates how insolvency legislation protects pensions

Argument: In 2004 Air Canada entered insolvency proceedings and retained almost 30,000 employees who continued receiving their pensions. Had super-priority been law, it is likely Air

Canada would not have been able to emerge from their insolvency proceedings, leading to the loss of these jobs as well as the ongoing ability to pay pensioners.

CFP Reality Check: It is surprising the Air Canada bankruptcy is raised as an example of how a CCAA restructuring preserves pensions. In fact, Air Canada's pension deficit continued to balloon following its CCAA restructuring. It took many years and strong intervention by then Finance Minister Jim Flaherty, to compel Air Canada to fully fund its pension.

Air Canada's pension is federally regulated. At the time of its insolvency, Air Canada had a $1.3 billion pension deficit. This shows a failure of the federal regulatory regime. Air Canada should not have had a pension deficit to deal with; it shouldn't have been a factor in the insolvency.

While Air Canada used the CCAA to successfully restructure, that restructuring did not fix the pension problem. Even with the pensioners agreeing to concessions providing Air Canada solvency relief, the pension deficit continued to increase and Air Canada sought additional solvency relief several times. While executive bonuses, based on internal performance measures, continued to be paid.

For example, earnings used to measure senior executive performance in 2006 were 107.5% of the earnings target resulting in incentive awards equal to 178.5% of the targeted bonuses. That was the short-term incentive program. There was also a long-term incentive program that, for example, provided a targeted stock option grant to the CEO of 280% of base salary.

By 2013 Air Canada's pension deficit ballooned to $4.2 billion. Air Canada, once again, sought further relief.

This time, the finance minister (Jim Flaherty) agreed to further relief, but it came with restrictions that would remain in place until Air Canada's pension was fully funded. Executive compensation increases were capped at the rate of inflation. Special bonuses were prohibited, and other incentive plans were severely curtailed. The airline was also prevented from paying dividends and buying back stock. With these restrictions in place, Air Canada managed to fully fund the pension by May 2015 -- in just two years.

Air Canada's pension was addressed when the rules were changed and corporate behaviour changed. CFP has long held that changing the rules by extending super priority to the pension deficit will not result in massive business failure, it will lead to a change in business behaviour and better funded pensions.

Governments have held consultations and addressed concerns about pension protection

Argument: Governments have held national consultations to hear directly from pensioners, workers, lenders, and companies. Legislative changes have been made to address pension security.

CFP Reality Check: Consultations simply have not resulted in any appreciable improvement to pension protection in insolvency.

While there have been legislative changes over the years, none have come close to solving the problem. Pensioners deserve 100% of the pension their employer committed to, even in insolvency.

For example, the latest government effort was Bill C-97 (June 21, 2019) The government claimed it will:

"make insolvency proceedings fairer, more transparent and more accessible for pensioners and workers. Changes to federal corporate law have provided for better oversight of corporate behaviour, and will help better align corporate decision making with pensioner interests."

Unfortunately, as with past government efforts, Bill C-97 introduced only modest changes. It has many significant shortfalls and does not offer real protection for pensioners.

Much is made of Bill C-97 introducing the concept of fairness to insolvency proceedings, but "fairness" is not defined in legislation. It will take years of litigation to establish what "fairness" means in regards to pensions in insolvency. A trip to the Supreme Court of Canada takes years and millions of dollars. This requires money and time that vulnerable seniors, facing a permanent reduction in their income and loss of health care benefits, simply don't have. This is not fairness.

Bill C-97 changes to federal corporate law only impact federally registered companies, a small fraction of companies in Canada. The government of Canada needs to provide a solution for all Canadians.

Pension contributions are already at the front of the line

Argument: Outstanding pension contributions are already at the front of the line in insolvency proceedings.

CFP Reality Check: The only contributions that are prioritized in an insolvency are normal contributions, NOT the catch up to address existing pension deficits (unfunded liabilities). Normal contributions are minor compared to the unfunded liabilities.

Under these rules pensioners of Nortel, Sears, Atlantic Co-op, Cliffs Natural Resources, etc. all experienced significant reductions to income for the rest of their lives.