KOSKIE MINSKY

JUSTICE MATTERS

Pension and Benefits

This is a summary of Pension and Employee Benefits matters of interest.

Two Approaches to Solvency Funding Reform: A summary of Ontario's Consultation Paper

Ontario is currently in the process of reviewing solvency funding rules for single employer defined benefit ("DB") pension plans under the *Pension Benefits Act.* On July 26, 2016, the Ministry of Finance released a "**Review of Ontario's Solvency Funding Framework for Defined Benefit Pension Plans**" Consultation Paper soliciting feedback on a number of potential reforms for solvency funding.

By way of background, economic conditions, including persisting low interest rates after the 2008 global recession, have resulted in successive rounds of temporary solvency relief for DB plans in 2009, 2012, and 2016. The Consultation Paper identifies the need for a review of funding rules to ensure they are appropriate for different economic conditions, including those currently affecting DB plans. The Paper contemplates the proposed reforms applying to both private plans and "broader public sector" pension plans.

Background on Funding Rules

The existing funding rules use two types of funding valuations to determine contribution requirements and solvency. **Going Concern Funding** assumes a plan will continue indefinitely. **Solvency Funding** calculates the funding required to pay benefits if a plan were to wind-up on the valuation date. The Consultation Paper proposes two general approaches to reform. Many of the proposed options resemble policy reforms already adopted in jurisdictions across Canada.

Approach A: Modified Solvency Funding Rules

Approach A would maintain the principle of solvency funding, but would modify existing requirements to address certain concerns. The Consultation Paper proposes the following options, one or more of which might be implemented:

1. **Average Solvency Ratio:** Plans would be required to fund a deficiency determined by average solvency ratio as opposed to a solvency deficiency in any one year.
2. **Lengthened Amortization Period:** The period of time over which solvency deficiencies must be amortized would be lengthened (e.g. to 10 years).
3. **Consolidation of Solvency Deficiencies:** Solvency deficiencies would be consolidated and re-amortized at each valuation (i.e. a "fresh start").
4. **Funding a Percentage of the Solvency Liability:** Solvency funding targets would be adjusted from 100% to a reduced percentage of the solvency liability. Changes to the PBGF might be made to mitigate decreased benefit security.
5. **Solvency Funding for Certain Benefits Only:** Normal retirement benefits would be funded on a going concern basis only. Changes to the PBGF might be made to mitigate decreased benefit security.
6. **Solvency Reserve Accounts (SRAs):** Sponsors would be allowed to withdraw some surplus through the use of SRAs, up to a prescribed maximum, where the solvency position exceeds a threshold in excess of 100%.
7. **Letters of Credit (LOCs):** A higher limit on the use of LOCs by sponsors would be allowed (current limit is 15%).

Approach B: Eliminate Solvency Funding Rules and Strengthen Going Concern Funding:

This approach would strengthen going concern funding requirements for DB plans, while eliminating the current solvency funding rules. The following options are proposed:

1. **Require a Funding Cushion (Provision for Adverse Deviation):** Plans would be required to set aside certain assets in excess of a plan's liabilities before the plan would be allowed to take actions that could weaken its funded position.
2. **Shortened Amortization Period:** Special payments to fund going concern liabilities would be amortized over a period shorter than 15 years.
3. **Restrictions on Return on Investment Assumptions:** Regulations would require that plan actuaries not exceed a maximum best estimate interest rate.
4. **Solvency Trigger for Enhanced Funding:** Solvency would continue to play a role in funding through use of the solvency position to determine if additional funding is needed.
5. **Enhance the PBGF**: The PBGF would be required to fund larger claims in the event of a wind-up of an insolvent employer.

Additional Complementary Reform Measures:

The Paper also proposes additional measures that could be implemented alongside either of the two approaches:

1. **Annual Valuation Reports:** Plans would be required to file annual actuarial valuation reports

disclosing going concern and/or solvency financial positions.
2. **Written Policies:** Plans would be required to establish and file funding and governance policies, in addition to the SIP&P.
3. **Commuted Values:** The commuted value entitlement on termination would be modified to be more reflective of the underlying risk associated with the pension benefit.
4. **Restrictions on Contribution Holidays and Benefit Improvements**: Contributions holidays could be permitted only if a PfAD was fully funded.
5. **Administrator Discharge for Annuity Buyouts**: Plan administrators would be discharged from certain obligations upon the purchase of annuities from insurers.
6. **The PBGF**: Benefits guaranteed by the PBGF would be increased above $1,000.

Consultation Process

Many of the proposed options could have significant implications with respect to benefit security and/or the obligations of plan administrators.

Consultations with the stakeholders and experts are intended to continue through fall 2016, with written submissions on issues relating to funding accepted from all interested parties until September 30, 2016.

Finally, Canada Pension Plan (CPP) Enhancement

On June 20, 2016, Canada's Finance Ministers reached an historic agreement to improve core retirement income benefits under the CPP. The agreement followed years of tumultuous pension politics, including an outright refusal in December 2013 by the Harper Government to consider any changes to the CPP.

Following the breakdown in federal-provincial CPP discussions, the Wynne Government campaigned on a commitment to CPP reform or, if Ottawa exercised its veto, to a made-in-Ontario "Ontario Retirement Pension Plan" ("ORPP").

Ontario did in fact introduce three pieces of legislation to establish the ORPP. It created the ORPP Administration Corporation ("ORPPAC"), appointed a Board of Directors, created a plan text and a funding policy and commissioned an initial valuation of the Plan. The ORPPAC Board hired a CEO and staff, leased premises, issued RFPs for key services and prepared to bring the ORPP on stream effective January 1, 2018.

In the meantime, the Canadian Labour Congress (CLC) and many trade unions continued their decades long advocacy for CPP reform, culminating in forceful media campaigns and a very effective political lobby. By June 2016, and for some time before, Canadians well understood the retirement income gap, and pressed for change.

Ultimately, the labour movement and the Province of Ontario changed the conversation about public pensions in Canada. By June 2016, the *status quo* was no longer tenable. Either the ORPP would proceed, or the CPP would be enhanced. Inaction was no longer an option, and was no longer supported by Canada's new federal government.

The outlines of CPP reform remain bare. However, the following is clear:

1. Ontario will not be going forward with the ORPP;
2. the current CPP replacement rate, which operates on income up to the "Years' Maximum Pensionable Earnings" ("YMPE"), will increase, between 2019 and 2023, from 25% to 33.3%;
3. then, in 2024 and 2025, the YMPE will be increased by 14% to an estimated $82,700 in 2025;
4. the enhanced CPP will be fully funded, but decisions have not yet been announced as to how enhanced CPP contributions will be managed and invested;
5. increased CPP contributions (roughly 1% for employees and matching contributions for employers) will be tax deductible – an improvement over the current tax credit; and
6. the working income tax benefit will be enhanced, as a way to assist low-income earners with increased contribution rates.

Although CPP enhancement was agreed in principle on June 20, 2016, the Government of the Province of British Columbia has initiated a public consultation about it, and did not formally ratify the agreement by the July 15, 2016 deadline. It is widely believed, however that British Columbia will confirm its agreement to the enhancement.

We do not expect that CPP contributions will be subject to limits on registered pension plan (RPP) or RRSP contributions, nor will the RPP/RRSP tax rules be changed or limited to offset an enhanced CPP.

The precise schedule of contribution increases and accrual rate improvements over the 2019-2023 period is yet to be specified. Administrative, investment and governance decisions have not yet been confirmed.

Employer and trade union sponsors will no doubt consider the economic impact of the CPP enhancement on existing retirement benefits. They will decide whether to integrate the CPP enhancement into existing benefit arrangements, or to add the enhanced benefit to existing offerings. In some cases, plan terms may provide a clear enough starting point for considering the impact of the CPP enhancement on existing programs, while in other cases existing provisions concerning the CPP will provide no guidance as to how the enhancement will affect existing plan provisions.

We may expect additional details with respect to the CPP enhancement in the coming weeks, and may also expect legislation to be introduced in the Federal Parliament this autumn.

Co-op Atlantic CCAA highlights the need for Representative Counsel at an early stage

On June 25, 2015 Co-op Atlantic, a co-operative wholesaler operating across Atlantic Canada and Quebec obtained protection from its creditors under the CCAA. Ten months later, in April, 2016, Co-op's pension plan members received a letter that no retiree ever wants to receive. An actuarial and consulting firm, which had been appointed by the New Brunswick Superintendent of Pensions to wind up the underfunded pension plan, sent notice to the retirees that their monthly pension benefits were being cut by 32%. As a result, many elderly retirees have had to return to the workforce to make ends meet – hardly the notion of a happy retirement.

The Co-op Atlantic CCAA became a perfect storm of bad events for the non-union employees and retirees (**"Salaried Members"**), some of which might have been prevented if they had legal representation at an early stage.

Co-op non-union employees and retirees did not have legal representation in the CCAA proceedings

All of the other major parties involved in the CCAA proceeding (e.g., banks, lenders, unionized employees) had legal counsel to protect and advance their interests. Indeed, on July 20, 2015, shortly after the CCAA proceeding commenced, the two unions involved in the case applied to the CCAA judge for representation orders for their members, which the CCAA Judge issued. Unfortunately, no one sought or recognized the need for the same type of order for the Salaried Members. This group of individuals were left unrepresented as the CCAA quickly moved forward.

What is a representation order?

A representation order is an order of the court which can be issued under the CCAA, the*Bankruptcy and Insolvency Act* (for bankrupt companies) and the various provincial rules of civil procedure. The purpose of such an order is to facilitate the representation of a large group of individual creditors who are impacted by complex insolvency proceeding so that all of the group members can be represented by a single voice, and the rights of all the group members are protected and advanced by independent legal counsel. Representation orders are commonly issued by courts across Canada for employees and retirees in insolvency proceedings, as well as other creditor groups such as payday loan borrowers, class action claimants, and even shareholders. Courts across Canada have recognized the need and benefit of such orders for individuals who have little means to pursue representation in legal proceedings of significant complexity. Justice Sarah Pepall summarized the rationale behind representation orders in the***Canwest*** CCAA, which has been followed in numerous subsequent cases:

> In my view, this watch and wait suggestion is unhelpful to the needs of the Salaried Employees and

> Retirees and to the interests of the Applicants. I accept that the individuals in issue may be unsecured creditors whose recovery expectation may prove to be non-existent and that ultimately there may be no claims process for them. I also accept that some of them were in the executive ranks of the LP Entities and continue to benefit from payment of some pension benefits. That said, **these are all individuals who find themselves in uncertain times facing legal proceedings of significant complexity.... It would be of considerable benefit to both the Applicants and the Salaried Employees and Retirees to have Representatives and representative counsel who could interact with the Applicants and represent the interests of the Salaried Employees and Retirees.** (2010 ONSC 1328, at para. 24)

No prior notice of the motion to approve the Settlement Agreement

Another major advantage of a representation order is that representative counsel actively participates in the CCAA proceedings and will receive prior notice of all court motions so that they can be reviewed and effectively addressed. In Co-op, the unrepresented Salaried Members were not given prior notice of the most important event in the CCAA proceeding: the motion brought by the company to approve a settlement agreement that had been negotiated between the company, the secured creditors and the appointed administrator. As the Salaried Members later learned, the settlement agreement mandated the distribution of the bulk of the funds in the estate of Co-op. Without prior notice, the Salaried Members had no opportunity to review or provide input on the settlement prior to it being presented to the court by other parties for approval. The terms of the Co-op settlement agreement provide for the secured creditors to be paid 80-95% of their loans, plus their legal costs, while Co-op's pension plan recovered a mere 7% of its claim.

What happened to the pension priorities?

In 2013, in a landmark case, Supreme Court of Canada in ***Indalex*** confirmed the applicability of the statutory deemed trust in provincial pension benefits statutes for amounts owing to a pension plan as a priority over secured creditors. The Supreme Court's ruling in *Indalex* led to a meaningful settlement for retirees in that case, and also led to a priority recovery to unions in the subsequent CCAA case in ***Timminco***. Further, considering that the New Brunswick Superintendent of Pensions had ordered a partial wind up of the Co-op Atlantic pension plan as of June 20, 2015, which was *before* the CCAA filing, the poor recovery to the Co-op Pension Plan in the Settlement that was approved by the court is difficult to understand.

When the pension reduction letters started arriving in the retirees' mailboxes in late April, 2016, many retirees realized something was wrong. A group of about 100 retirees quickly formed and contacted Koskie Minsky LLP for assistance. On June 27, 2016 a motion was brought before the CCAA Judge in St. John, New Brunswick for a representation order for the Salaried Members. The company, CCAA monitor and the appointed administrator opposed the motion and argued that the Salaried Members had been adequately covered by other "pension interests" such as the unions and the appointed administrator.

However, the Salaried Members argued that those who were alleged to have “covered” their interests did not in fact represent them. Further, while the administrator may be able to compromise its statutory lien and charge priority, the statutory deemed trust claim is only for the pension plan beneficiaries to compromise not any other party. The CCAA Judge dismissed the motion for a representation order. The reasons seemed to be largely that it was too late in the CCAA proceeding and a concern of the court about the Salaried Members possibly challenging the Settlement.

What does this mean for employees and retirees who become subject to an insolvency proceeding?

Insolvency proceedings by their nature involve battles among competing creditors fighting over a limited pool of funds. Banks, lenders and other creditors have independent and specialized counsel to represent them, and typically arrange in their loan documentation that all their legal costs are to be paid by the company in any insolvency proceeding. Employees and retirees who find themselves involved in such a proceeding should reach out to legal counsel quickly. Had a representation order been sought and issued earlier for the Salaried Members of Co-op Atlantic and their pension priorities vigorously advanced, the outcome for them would likely have taken a different and more favorable turn.

This post was authored by members of Koskie Minsky’s Insolvency Group.

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