**A Primer on the Administration of Insolvent Pension Plan Wind Ups in Canada**

With a federal constitution, jurisdiction over pension matters in Canada is shared between the federal Government and the Provinces. The Federal Regulator has jurisdiction over pension plans primarily based in the three territories, as well as over the pension plans of companies in “federally regulated” industries such as telecommunications and interprovincial or international transportation. All other pension plans are provincially regulated.

The Province in which a plan is registered is the Province where a plurality of the members are employed. In general, the Province of Registration determines the administrative requirements that a plan must comply with, but members rights they are governed by the province of employment’s pension legislation. This means that the wind up must comply with several provinces’ pension wind up rules.

Pension legislation in Canada provides regulators with the ability to either step in and act as a pension plan administrator under a number of prescribed circumstances or to appoint a replacement administrator with a mandate to administer and wind up the pension plan. The bulk of the appointments are made in Ontario, where about 50% of Canadian pension plans are registered (Ontario has the bulk of manufacturing rust-belt industries that have been subject to the highest rates of corporate insolvency).

The circumstances under which a regulator can appoint a replacement administrator include bankruptcy, failure to contribute, cessation of business, inability or unwillingness to administer then plan, or, in the case of Ontario where there is a guarantee fund, the appointment is “necessary to prevent an increase in the liability of the Guarantee Fund”.

Traditionally, administrators’ appointments were only made when a plan-sponsor filed under the *Bankruptcy and Insolvency Act* (*BIA*), where it was clear that both corporate and pension plan termination were inevitable. Appointments were not made when companies obtained creditor protection under the *Company’s Creditors Arrangement* Act (*CCAA* – roughly equivalent to Chapter 11 in the US) because there remained a chance that the company could restructure and the pension plan could continue in existence.

For a variety of reasons, a growing number of companies that are ceasing operations are doing so through the *CCAA* process and not through bankruptcy. As a result, it is becoming more common for administrators to be appointed in *CCAA*. Additionally, there has been a recognition by regulators that employers may be conflicted in their role as pension plan administrators when making restructuring and/or insolvency decisions, and this conflict was recently recognized by the Ontario Court of Appeal in the decision in Indalex (currently under appeal to the Supreme Court of Canada). One of the implications of Indalex may be that employers undergoing financial stress will be less willing to act as administrator of their own pension plans even prior to entering CCAA. Administrators are increasingly finding themselves appointed in circumstances where there remains a possibility that the Company may successfully restructure or a “white knight” may appear and purchase the Company and continue the pension plans. In these circumstances an appointed administrator will typically defer taking any irrevocable steps in winding up the plans recognizing that the continued existence of the Plans is generally in the best interests of the members.

**DC Wind Ups**

Defined Contribution (DC) pension plans first are typically simple to wind up. Often regulators don’t appoint replacement administrators and will simply ask the insurance company that is custodian of the Plan to produce a windup report and convert the member accounts into locked-in retirement savings plans. The process is typically short and inexpensive.

An exception to this is where there are significant issues related to the DC plan such as missing or unpaid contributions, issues related to forfeiture accounts, where the insolvent employer is an insurer company and itself the custodian of the Plan.

Unremitted pension contributions owing to a DC pension plan were recently provided with priority over secured creditors under Canada’s insolvency laws. Recovering these from the estate of the insolvent employer should be relatively easy.

In Canada, pension minimum standards in most jurisdictions provide that members’ pensions vest after two years of membership. Where members terminate employment prior to vesting, they are entitled to receive back their own contributions (i.e. not the employer’s contributions) with interest. Employer contributions in respect of the member are placed in a forfeiture account and are typically used for continuing contributions. Appointed administrators often use forfeiture accounts first to pay for wind up administration expenses, absent which administration expenses are typically charged to members’ accounts.

When a plan is wound up, however, a wind up period is typically recommended by the administrator which usually covers the period during which a significant corporate downsizing has occurred. The period is important because members terminated during the period become part of the “wind-up group” and may be entitled to certain pension enhancements such as grow-in rights or surplus entitlement (while these are defined benefit issues, many plans have both DB and DC components. Members who are part of the wind up group also are automatically vested in some Canadian jurisdictions. The upshot of this is that a number of those members whose DC pension entitlement may have been forfeited because they were non-vested suddenly become vested as a result of the wind up process, and the corporate sponsor or its estate will have to replace any money that may have been taken. The lesson for restructuring officers is to be very careful with forfeiture accounts.

**DB Wind Ups**

DB plans are far more difficult to wind up than DC. Again, it is important to note that though the plan may be registered in a specific provincial jurisdiction, the rights that Plan members have on wind up is determined by the legislation of the provinces in which the members were employed, and these rights vary considerably by jurisdiction.

For example:

- Ontario is the only province with a guarantee fund, and the fund applies only in respect of Ontario service, so members with employment in more than one province get guarantee fund coverage for only a portion of their pensions.

- Because of Ontario’s PBGF rules, the Ontario wind up funded ratio is *fixed* as of the wind up date. Any experience gains or losses (e.g. mortality, interest rate changes, etc) that occur subsequent to that date and prior to settlement are borne by the PBGF, whereas in other provinces they are borne by the members. This means that interim cuts made pending settlement are typically deeper for non-Ontario members due to the need to maintain a Provision for Adverse Deviation.

- Ontario rules eliminate prospective indexation from the plan, which results in the elimination of the liabilities associated with indexation for Ontario members and increases the funded ratio for Ontario members. This higher funded ratio for Ontario members can create significant communications challenges for an appointed administrator where the members in other jurisdictions where indexation is maintained have a lower funded ratio. The elimination of indexation actually makes settlement much easier because indexed annuities and in particular deferred indexed annuities are very expensive to purchase in the Canadian market. Where a plan has indexed benefits, purchasing indexed annuities for non-Ontario members can be very challenging.

- Ontario and Nova Scotia members have entitlement to what we call grow-in benefits. Grow-in benefits mean that any member whose age plus years of service equal 55 or more are ‘deemed’ to continue employment for purposes of qualifying for early retirement provisions.

Members in other provinces only receive this benefit if it is part of the plan provisions.

A significant problem for appointed administrators of multi-jurisdictional plans is that employers typically do not administer their plans and maintain records in anticipation of insolvency and an underfunded wind up. For an on-going plan with full benefits being paid, the province of employment is largely irrelevant for pension administration purposes. When administrators are appointed, there may be a complete lack of data maintained showing the provinces in which pensioners accrued their benefits. This can make wind up a complex, expensive and largely forensic task, even where the now-bankrupt employer properly administered their pension plans. The complexity is often worse as proper pension plan administration often falls by the wayside when a company is lurching towards insolvency.

**Settlement of Benefits**

Province of employment also determines the options available to people on settlement of pension benefits. In general, most jurisdictions require annuities to be purchased for pensioners and provide that members not yet in receipt of a pension be provided with an election to take either a deferred pension or a lump-sum transfer of a commuted value of their pension to a locked-in account. Quebec is a major exception to this rule in that it provides the option to commute their pensions to pensioners and requires deferred members to take a lump-sum.

Locking-in rules for the accounts that members can transfer their pension entitlement to vary by jurisdiction (locking-in means that the owner of the account can only withdraw a prescribed portion of the account every year – they can't use the account for anything other than providing a retirement income). Some jurisdictions permit a portion of the transferred amount to be unlocked in varying amounts either absolutely or due to financial hardship, shortened life expectancy or non-Canadian residency. While it is the responsibility of the financial institution accepting the commuted value transfer to administer these different rules, the appointed administrator has to inform the financial institutions which jurisdiction's rules apply. In general, for purposes of determining the jurisdiction whose rules govern the options available on settlement, it is the province in which the member *terminated* employment that matters, even though they may have earned benefits in several provinces.

Quebec, alone among provinces, permits pensioners only to transfer their pension entitlement to the Regie (the Quebec Regulator), but only if the pension plan is underfunded and the employer sponsor is bankrupt. The Regie will then pay pensioners their reduced pensions for a period of up to 10 years while investing the money received in a non-immunized portfolio. If the portfolio earns excess returns, pensions may be increased, whereas if the portfolio loses money, the Province guarantees that pensions will not be reduced. This is a nodown side risk option for pensioners. Clearly with no-downside risk the pensioners have an interest in the portfolio having as much risk as possible whereas the Province wants the least risk by as much immunization as possible. The Regie has about 20% of the assets under its administration invested in equities so the risk assumed is relatively small.

**Insolvency Claims**

In addition to the administration of pension benefits pending settlement, a major task of the appointed administrator is to prepare, file and pursue claims against the estate of the employer for amounts owing to the pension plan. The rule in all Canadian jurisdictions is that the employer remains liable for funding the entire deficit in the pension plans. Until recently, some jurisdictions (most notably the federal legislation) did not provide for employer liability to fund deficits on wind up, enabling some employers to simply walk away from legacy pension liabilities, but this has now been changed.

The *Bankruptcy and Insolvency Act* (*BIA*) is federal legislation and prescribes the priority of creditor claims on insolvency. The BIA provides a superpriority for claims in respect of unremitted employee pension contributions deducted from pay, unpaid employer contributions under a DC plan, and unpaid normal cost contributions under a DB plan. Special payments for outstanding solvency deficiencies or going-concern unfunded liabilities are not subject to this superpriority, and typically rank as unsecured claims.

Ontario's *Pension & Benefits Act* (*PBA*) provides that there is a deemed trust in favour of pension plan beneficiaries on "an amount of money equal to employer contributions accrued to the date of wind up but not yet due under the plan or regulations" and provides the administrator with a lien and charge over the assets of the employer's assets in respect of the trust. The *PBA* also provides the Superintendent with a lien with regard to any PBGF monies paid into the plan.

For a variety of reasons, including the stilted language in the statute, insolvency rules and the federal nature of Canada (the *PBA* is provincial but the *BIA* is federal and you can't use a provincial statute to "amend" a federal statute), obtaining priorities for pensions deficits in insolvency have been generally unsuccessful, and pension deficits, other than for unpaid contributions, have been held to be unsecured claims. The recent case of Indalex, currently before the Supreme Court of Canada, has challenged this, and it will be interesting to see how our highest Court treats this controversial case.

**Process**

As far as the regulatory hurdles that must be met across jurisdictions, they are broadly similarly. A Wind Up order must be obtained from the Regulator, and a wind up report filed for the regulator's approval. Plan beneficiaries may object to the wind up report, which usually means it is reviewed by an administrative tribunal and then subject to judicial review. Once the wind up report is approved benefits are settled either by annuity purchases or lump-sum transfers. Depending on the size of the plan and plan complexity the wind up process for DB plans can range in length from about 18 months to 7-8 years. The relatively small size of the Canadian annuity market makes the wind up of very large plans protracted so as to avoid swamping the annuity market. DC plan wind ups, usually settled by lump-sum transfers, are fairly short.

One of the questions contained in the conference program outline is "Who Pays" in the event of underfunding. The short answer in Canada is that the beneficiaries pay and that, in general, benefits are reduced pro rata to the funded status of the Plan. There are exceptions to this in that in Ontario, the PBGF pays, which means the sponsors of other DB single-employer plans pay or the Government pays, depending upon who you feel is really responsible for the PBGF.

There are some express priority schemes in Canada when a pension plan is underfunded. Some provinces permit priority schemes that see the liabilities associated with retirees settled and then, only after these benefits are fully paid, are liabilities settled for deferred members or actives. Ontario's PBGF rules favour members with smaller pensions (under $1,000) but also favour longer service members and retirees by starting guarantee fund coverage only where age plus years of service equal 50 or more. The PBGF elimination of indexation also has a greater relative impact on younger members over older members in those plans that are indexed.

The administration of pension plans in wind up as a result of insolvency can be complex and protracted. The above commentary only highlights a small number of the many issues faced by appointed administrators in Canada.