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Client Advisory

Bill C-228: New legislation will give super-priority to pension debt

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Summary

Legislation that would amend bankruptcy and insolvency rules for employers across Canada cleared a major hurdle after passage by the federal House of Commons. Where an employer is insolvent, the amendments would give super-priority to pension deficits, including over secured creditors. This may cause lenders to review their approach to underwriting credit for employers with DB pension plans.

Introduction

By a vote of 318 to 0, Bill C-228 passed third reading in the federal House of Commons on November 23, 2022. This bill includes amendments to federal bankruptcy and insolvency legislation that would dramatically increase the priority of claims relating to an underfunded defined benefit (DB) pension plan when the employer is bankrupt or is restructuring under the *Companies' Creditors Arrangement Act*. While the bill must still be passed by the Senate and receive royal assent, the unanimous Commons vote is a significant step towards it becoming law. Employers who sponsor defined benefit pension plans should consider the possible effects of these changes on the availability and cost of credit.

The bill is currently at second reading in the Senate. It must still be passed at second and third reading and may be reviewed by a Senate committee prior to third reading. The Governor General must then give royal assent. The Senate can amend the bill, but the House of Commons must agree to the amendments. Once the Senate passes the bill, royal assent is generally a formality. Regardless of the effective date, there is a four-year transition period as noted below.

Bankruptcy and insolvency changes

Bill C-228 would amend both the *Bankruptcy and Insolvency Act* (BIA) and the *Companies' Creditors Arrangement Act* (CCAA) to give a greater priority to a deficit in a DB pension plan where an employer is insolvent or seeks to reorganize under the CCAA. While the BIA and CCAA are federal

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statutes, they apply across Canada and the amendments would, therefore, apply to both federally and provincially registered pension plans.

The amendments would extend, to the pension deficit, the level of priority that is currently only given to pension normal costs and to employee contributions that are withheld from pay but not yet remitted to the pension fund. This would mean that the deficit relating to a pension plan would have a higher priority than most loans from secured creditors, including banks.

The changes would only apply to employers with a registered DB pension plan. They would not apply to a supplemental plan that provides benefits above tax limits or to non-pension post-retirement benefits. The language of Bill C-228 would amend the federal bankruptcy and insolvency legislation to require funding of both a solvency deficiency and a going concern deficiency.

It is unclear how the requirement to fund would apply to a provincially registered pension plan since it would apply federal funding regulations to a plan that was following applicable provincial funding regulations. It is also unclear how the legislation would apply to a type of plan that is not currently recognized under the PBSA (e.g., target benefit pension plan).

Transition period

The amendments to the BIA and CCAA would only become effective four years after the bill comes into force for an employer with an existing DB pension plan (the original bill had a five-year transition period).

Possible effects on borrowing

While the increased priority for pension deficits on insolvency will better secure benefits for plan members, it could have a negative impact on an employer's ability and cost to borrow because it would increase the risk of non-payment to lenders, including secured lenders.

It is difficult to predict how lenders will react, but it is possible that they will take steps to limit their risk, and such action might include restricting available credit, requiring more collateral, increasing the cost of credit, imposing restrictive covenants, and/or requiring more scrutiny and monitoring of a DB plan's funded status. If lenders' underwriting practices begin to consider, for example, the size of DB liabilities relative to the size of the business, or to look at the funded level or the asset mix of the DB plan, then employers who sponsor a DB plan may wish to revisit their funding and investment policies and consider de-risking or shrinking their plan.

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Paul Timmins, +1 416-960-7400
paul.timmins@wtwco.com

Gus van Helden, +1 403-261-1459
gus.van.helden@wtwco.com

Charles Lemieux, +1 514-982-2208
charles.lemieux@wtwco.com

Simon Laxon, +1 416-960-2621
simon.laxon@wtwco.com

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