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the proposed federal pension plan workout scheme: some preliminary observations

Canada's federal *Pension Benefits Standards Act, 1985* ("**PBSA**") was recently amended to include a unique distressed pension plan workout scheme ("**workout scheme**") as part of the Federal Government's overall pension reform proposals, and in response to funding problems affecting Nortel and other high profile defined benefit pension plans. The workout scheme is designed to provide a statutory mechanism to allow an employer who sponsors a federally regulated active pension plan with breathing room in which to negotiate and restructure potentially crippling pension obligations. If successful, the negotiations will result in a reordered amortization schedule of the statutory special or "catch-up" payments that the employer is obligated to make to in order to fund deficits that have developed in the pension plan. The workout scheme does not provide an employer with any relief with respect to its statutory obligations to fund the ongoing normal pension costs of the pension plan.

The following summarizes key features of proposed amendments to the *PBSA Regulations* (the "**Regulations**") in respect to the workout scheme that were published on December 18, 2010. The government has reserved the right to make revisions before the amendments to the Regulations are made into law.

who may access the workout scheme?

The PBSA applies to the registered defined benefit pension plans sponsored by employers in federally regulated industries such as banking, telecommunication, interprovincial transportation and airlines. The number of Canadian employers who would be eligible to access this workout scheme is relatively small since only approximately 7 per cent of private Canadian pension plans are subject to PBSA.

Federally regulated plan sponsors in the process of being liquidated, or who have made an assignment in, or have become bankrupt, may not access the scheme. Plan sponsors subject to proceedings under the *Companies' Creditors Arrangement Act* ("**CCAA**") or Part III of the *Bankruptcy and Insolvency Act* ("**BIA**"), may access a modified form of the workout scheme.

accessing the workout scheme

Based on the proposed amendments to the Regulations, an eligible plan sponsor or employer would access the workout scheme by making and submitting a declaration (the "**Declaration**") to the Office of the Superintendent of Financial Institutions ("**OSFI**" or the "**Superintendent**") that:

1. the employer does not anticipate being able to meet its pension payment obligations;
2. the employer intends to negotiate with the representatives of the members and beneficiaries with the purpose of entering into a workout agreement; and,
3. indicate the portion of the plan's special payments it intends to defer; or
4. the employer is subject to proceedings under the CCAA or BIA.

The board of directors of the employer must authorize the Declaration by a resolution that would be filed along with the Declaration with the Superintendent, and provided to the Minister of Finance (the "**Minister**") and the pension administrator. The employer would also provide notice of the Declaration to pension plan members and beneficiaries.

Once the employer files and provides notice of the Declaration, the employer would apply to the Federal Court to appoint separate representatives to negotiate on behalf of the beneficiaries and any non-unionized members (the "**Application**"). The employer, and not the pension plan, is responsible for the cost of the Application and for reimbursing the reasonable fees and expenses of the appointed representatives.

negotiation period and deferred payments

Once the Declaration is filed, and the Application approved, the workout scheme intends that the employer and representatives will begin a negotiation period that will result in a new pension funding schedule ("**Negotiated Special Payment Schedule**") in respect of statutorily required special payments. The published amendments to the Regulations propose a negotiation period of 90 days, with a possible extension by the Minister (the "**Negotiation Period**").

During the Negotiation Period, an employer that is not subject to proceedings under the CCAA or Part III of the BIA may defer remittance of a portion of its required special payments ("**Deferred Payments**") and such Deferred Payments will not be subject to a deemed trust. The employer remains obligated to remit its pension contributions for the normal costs of the plan and any employee contributions that have been withheld by, or remitted to, the employer.

Under the proposed amendments to the Regulations, the Negotiation Period and the workout scheme will terminate and Deferred Payments become due and subject to a federal deemed trust immediately if:

- the employer enters a CCAA or BIA proceeding; or
- the workout agreement fails to provide for remittance of the Deferred Payments; or,

- if the parties do not reach a workout agreement by the end of the Negotiation Period.

Ministerial approval of the Negotiated Special Payment Schedule

The Minister is required to approve the Negotiated Special Payment Schedule before it can take effect. The Minister cannot approve a Negotiated Special Payment Schedule if one third (or more) of the plan members or the beneficiaries object. Once approved, the Negotiated Special Payment Schedule will be incorporated into the prescribed tests and standards for solvency in valuing of the future funded status and funding requirements of pension plan.

some preliminary observations

Under this new workout scheme the federal government is attempting to regulate what had become a patchwork of special company or plan-specific regulations. Familiar examples of federally-regulated plans include the Air Canada Pension Plan Solvency Deficiency Funding Regulations (2004); examples of Ontario-regulated plans include Algoma Steel Inc, Pension Plans (2002); Stelco Inc. Pension Plans (2006); and General Motors Pension Plans (2009). Other negotiations took place within the context of insolvency proceedings, and were tailored to the specific circumstances of the employer and the restructuring plan. Generally, in 2008 and 2009, every jurisdiction in Canada enacted some measure of temporary solvency funding relief in its pension legislation to address near term funding requirements that could not be reasonably met by plan sponsors, and in some cases, threatened the financial viability of the plan sponsors and the benefit security of plan members.

Do the workout scheme and proposed amendments to the Regulations go far enough? While creating the opportunity for a plan sponsor or employer to negotiate flexibility in the timing of special payments, the proposed amendments do not include any minimum level of participation in the process by plan members, beneficiaries and their representatives. An employer that has not commenced insolvency proceeding that wishes to participate in the workout scheme will be required to state as part of Declaration that the employer does not anticipate being able to meet its pension payment obligations. Could creditors of the employer interpret the Declaration and the other information made publicly available in the Application to be a declaration of its insolvency? The proposed amendments do not include any employer protection from actions taken by its creditors as a result of the employer filing the Declaration. Will creditors take action to tighten or eliminate credit terms to the employer as a result of its participation in a workout scheme? If this is a realistic possibility, then participation in the workout scheme could have the effect of potentially exacerbating the cash flow pressure on the employer that the workout scheme is presumably intended to alleviate.

An employer should consider how it could or should access the benefits of the workout scheme while protecting it from any unintended and potentially unwelcome

consequences of the proposed scheme. Part of its assessment will be how its creditor base may react to its participation.

A lender should consider how it should assess the impact of an employer/borrower's participation in a workout scheme on the lender's position. For example, an operating lender may be concerned about the uncertainty of the process and the additional costs to a plan sponsor to participate in, and to reimburse members for, the costs and expenses of participating in a workout scheme. Should lenders consider any new procedures to monitor and assess risk attributed to a borrower that sponsors a federally regulated defined benefit pension plan? For example, should a lender require the employer to give prior written notice of its intention to participate in the workout scheme?

The workout scheme and the proposed amendments to the Regulations do not appear to prohibit a plan sponsor from choosing to undertake the type of informal negotiations with the regulator that have taken place to date. Since the pension funding requirements of employers under a CCAA or BIA proceeding are determined in conjunction with the proceeding, and such employers do not benefit from the deferred payment mechanism, it is not clear what and whether there is any real incentive for employers in those circumstances to consider undertaking the proposed workout scheme instead of an informal negotiation. Further, it remains to be seen whether, once the government proclaims the amendments to the Regulations in force, the Superintendent or Minister will be willing to consider and negotiate arrangements with employers that are eligible to participate in a workout scheme but have decided to pursue an informal process rather than participate in the formal workout scheme.

This bulletin raises some preliminary issues about the proposed workout scheme and its potential impact on the varying interests of plan sponsors, members, regulators and creditors of the plan sponsors. Once the Regulations come into force, it may be easier to understand or predict how the workout scheme will work in practice and how potential participation risks can be best managed and benefits maximized in relation to the party's interests.

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