Pension Investment
Association of Canada

Association canadienne des
gestionnaires de caisses de retraite

November 19, 2010

Standing Committee on Industry, Science and Technology
Sixth Floor, 131 Queen Street
House of Commons
Ottawa Ontario
K1A 0A6
Via E-mail: indu@parl.gc.ca

Dear Sir/Madam:

PIAC has been the national voice for Canadian pension funds since 1977. Senior investment professionals employed by PIAC's member funds are responsible for the oversight and management of over $940 billion in assets on behalf of millions of Canadians. PIAC's mission is to promote sound investment practices and good governance for the benefit of pension plan sponsors and beneficiaries.

We are writing to you today to address a serious issue pertaining to defined benefit pension plans that would have significant negative implications for the value of pension fund assets for all our members, for corporate pension fund sponsors, debt issuers and, ultimately, the millions of Canadians who invest in corporate bonds as part of their retirement savings. Various parties have been seeking changes to Canada's bankruptcy laws to provide preferred creditor status to unfunded defined benefit pension plans upon plan termination, with the objective of enhancing the beneficiaries' protection in the event of the sponsor's bankruptcy (Bill C-501). PIAC is very concerned about the adverse financial implications of such proposed changes.

PIAC understands the intention of Bill C-501 is to provide enhanced security and financial support to the beneficiaries of pension plans. However, the negative implications on investment portfolios and credit markets are significant and ultimately, such a change will provide another impediment to the future of defined benefit plans in the Canadian private sector.

Legislation granting preferred creditor status for pension plan deficits would negatively impact existing creditors, i.e. corporate bond holders, as well as plan sponsors who rely on capital markets for financing. Firstly, Bill C-501 would have the effect of reducing the value of outstanding bonds in the market. Providing priority in the capital structure would reduce the security of existing creditors. The value of all outstanding securities would decline as creditors would demand higher yields to compensate for the additional risk and for lower recovery values received in a default situation. The impact on the market value would differ based on the credit worthiness of the issuer and would be particularly material for issuers with large pension deficits.

Next, the higher yields demanded by creditors would mean that upon seeking additional capital from the markets, issuers with defined benefit plans would experience higher financing costs and possibly reduced availability of credit as a result of Bill C-501. For weaker plan sponsors, it would severely limit their access to credit of any kind, including access to the bank market which is key to supporting business growth; and for those companies under bankruptcy protection it could actually impede a successful restructuring. It is also reasonable to expect the value of the plan sponsors' stock to suffer as a result of the increased borrowing costs and, in some cases, a negative affect on the plan sponsors' ability to access capital to finance its operations.

The implications of the above are significant for PIAC member pension plans and countless other Canadians. By reducing the value of the plan sponsors' bonds, it would create an immediate loss on the bond portfolios held by PIAC members and negatively impact the funded positions of our defined benefit pension plans. It would also instantaneously erode the retirement savings for thousands of Canadians, including seniors, for whom direct holdings in corporate bonds are a key component of their portfolios.

Furthermore, preferred creditor status for defined benefit pension plan deficits would place companies that offer defined benefit plans at a competitive disadvantage vis-à-vis companies that do not offer defined benefit plans. Canadian debt issuers with defined benefit plans would also be at a global disadvantage compared to companies in countries that do not provide such preferred creditor status such as the United States, Great Britain, the Netherlands and Germany. The result is that such legislation would serve to accelerate the private sector's move away from defined benefit plans.

Continuing to burden companies with incremental costs, including the costs associated with preferred creditor status for pension plan deficits, would impede the growth and prosperity of Canadian companies. The ultimate impact of Bill C-501 would be increased pressure on bond and equity prices leading to losses being incurred by the same pension plans the preferred creditor status proposal is professing to help. In already volatile financial markets, this added pressure on pension plan assets of PIAC members as well as Canadians who are saving on their own for retirement is neither welcome nor warranted.

Thank you for your attention.

Yours truly,

Algis Janusauskas
Chair

cc. The Honourable James M. Flaherty
Minister of Finance
The Honourable Tony Clement
Minister of Industry