<u>Creditor Access to Future Income Security Plans - Report 1997</u>

**SASKATCHEWAN DISCUSSION PAPER ON
CREDITOR ACCESS TO FUTURE INCOME SECURITY PLANS**

I INTRODUCTION

This project examines creditor access to future income security plans to satisfy debts.

On January 31, 1996, a Discussion Paper was circulated by the Alberta Commissioners to the provinces, the territories, the federal government, and 28 organizations across Canada including the Canadian Bankers Association, the Canadian Bar Association, insolvency practitioners, consumers associations, credit organizations, credit unions, life and health insurance organizations, trust companies, seniors' organizations and status of women organizations. The Discussion Paper asked for comments on several issues to be considered in formulating policy with respect to the exigibility of future income security plans and insurance contracts.

Based on the response to the Discussion Paper, the Alberta Commissioners presented a report to the Conference in August, 1996, entitled *Creditor Access to Future Income Security Plans and Insurance Contracts*. The Alberta Commissioners recommended that the Uniform Law Conference review the issue of creditor access to future income security plans and insurance contracts from the perspective of the following four principles:

(a) the plan holders/debtors' ability to maintain themselves and their families in the future;

(b) the protection of dependants named as beneficiaries under plans from access by creditors to plans after the death of the plan holder/debtor;

(c) the administrative burden and costs to third parties including other plan members and the tax implications to plan holder/debtors resulting from the premature termination of plans by creditors; and

(d) the use of plans by plan holder/debtors for the purpose of avoiding their responsibility to pay their creditors.

The Uniform Law Conference accepted Alberta's recommendation and resolved as follows:

<u>RESOLVED:</u>

That the steering committee be directed to establish a Working Group to work on the topic of exigibility of future income security plans and to prepare an issues paper and, if possible, a draft act for consideration of the 1997 Conference.

The purposes of this report are:

(a) to delve further into the issues regarding an exemption from exigibility of future income security plans; and,

(b) to make specific recommendations on how those issues could be addressed by legislation.

It is acknowledged from the outset that the importance and complexity of this issue will compel significant further debate with respect to the policy choices presented by this paper. By making specific recommendations, it is hoped that the debate on these issues can be additionally focused. Further consultations with the stakeholders engaged by the Alberta Commissioners will, in all likelihood, also be required on these or alternative recommendations before embarking on the final preparation of a Uniform Act.

II FIRST PRINCIPLES

A. The plan holder/debtor's ability to maintain themselves and their families in the future.

In considering the establishment of any potential exemption from exigibility it is of course imperative that the application of the exemption be carefully limited to the policy objective it is intended to address. "Future income security" is a broad term which can include the simple savings of funds in a good year for subsequent use in a bad year. For our purposes, for the reasons stated below, this paper will be focusing on retirement income in particular rather than future income in general. It will also focus on the retirement income of the debtor/plan holder rather than more general "family" or other dependants income. The extent to which these third parties benefit from any exemption from exigibility for the debtor/plan holder will, accordingly, be more indirect than direct.

Canada's retirement income system has three major components:

(a) Old Age Security/Guaranteed Income Supplement (OAS/GIS)

These government-sponsored programs guarantee a minimum income to all persons 65 years or older. OAS provides an income-tested flat-rate benefit. A supplementary benefit, GIS, is payable to those with no or little other income. Benefits are paid from the federal government's consolidated revenue fund. No direct contributions are required of recipients.

(b) Canada and Québec Pension Plans (C/QPP)

C/QPP are employment-related and are funded through employee and employer contributions. The programs cover almost all workers in Canada and are compulsory for those 18 years or over. Contributions are made by employees and employers on earnings up to a maximum. The maximum benefit is approximately 25% of average earnings.

(c) Private savings

Private savings includes money held in registered pension plans (RPPs), registered retirement savings plans (RRSPs), deferred profit sharing plans (DPSPs) and personal savings outside of these saving vehicles.

The focus of this report is on the relationship of creditors to private retirement savings. Several observations can be made with respect to private retirement savings which are critical to the recommendations of the report:

1. OAS/GIC and C/QPP are comprehensive and mandatory systems intended to provide elderly Canadians with a reasonable guaranteed minimum income. Governments do not require individuals to save in order to produce retirement income beyond that minimum level, but governments do encourage saving for retirement through the tax system.

RPPs, RRSPs and DPSPs are distinguished from other personal savings by their favourable tax treatment. Under Canada's tax system:

- individuals, and their employers with respect to RPPs, are permitted tax deductions for amounts contributed to RPPs, RRSPs and DPSPs; and
- investment returns on these contributions are not taxed as earned; but all benefits, including those attributable to investment returns, are taxed in full when they are received.

The "tax expenditure" associated with the retirement savings system is easily the largest of any incurred by the federal government:

"*The level of tax assistance provided to savings in registered pension plans, deferred profit sharing plans and registered retirement savings plans was estimated to be $14.915 billion at the federal level in 1991."*

Source: Creating a Healthy Fiscal Climate

Department of Finance, October 1994

The priority placed on personal retirement savings by government is justified by Canada's demographics. By the year 2031, it is expected that just short of a quarter of the population will be 65 or older.[(1)] As a percentage of the working age population, senior citizens will increase dramatically from 19.8% in 1995 to 38.9% in 2030.[(2)] As a result, the cost of Canada's social security programs (Medicare, C/QPP, OAS) is estimated to increase by more than 6% of gross domestic product, from about 8.5% of GDP to 15% - 16% of GDP, during the next 35 years.[(3)]

As reflected in the Alberta report, the growing recognition that private retirement savings are a necessity supports a recommendation from the Uniform Law Conference on an exemption. However, we also must acknowledge what is at stake in an exemption of RRSPs. At the end of 1993, about $177 billion was held in RRSPs (compared to $424 billion in RPPs). However, the amount accumulated in RRSPs grew 444% from 1983 to 1993, well above the growth rate in RPP assets of 191%, and the proportion of the labour force who made RRSP contributions doubled from 18% to 35% between 1983 and 1993.[(4)] In particular, the 1991 changes to the *Income Tax Act* (Canada) to increase the RRSP contribution limits and to permit a carry forward of unused RRSP room resulted in extraordinary growth in RRSP contributions and in RRSP contribution room. The new RRSP room for 1996 was a record $47 billion, up 3% from 1995, and tax filers carried forward another $132 billion in contribution room from previous years.[(5)]

It also is important to note that the focal point of public policy with respect to private retirement savings in Canada has been the *Income Tax Act* (Canada) (*ITA)*. It is therefore submitted as appropriate that an exemption policy should strive to work within the parameters provided by the tax system. This reality further suggests that provincial pension benefits standards legislation, while instructive, is more incidental to the discussion.

2. The level of tax assistance is established with retirement savings targets in mind. The federal government has indicated that a pension of 60% to 70% of pre-retirement earnings is that "generally considered...sufficient to avoid serious disruption of living standards".[(6)]

There are two types of retirement savings plans. A defined benefit pension plan is an employer-sponsored plan that pays benefits in accordance with a formula which takes into account factors such an employee's years of service, age and possibly earnings. A defined contribution or money purchase plan provides a pension based on the accumulation of contributions and investment earnings credited to an individual at retirement. RRSPs and DPSPs are money purchase plans.

The *Income Tax Act* (Canada) controls the level of savings in defined benefit plans by limiting the amount of benefits which can be paid to a participant. The level of savings under money purchase plans is controlled by placing limits on the amount of contributions which can be made to those plans.

Objections have been made with regard to the limitations imposed by the *Income Tax Act*(Canada):

"*The retirement savings system has been, and remains, a system for middle class Canadians. Low income Canadians do not need the retirement savings system - social security provides an adequate income. High income Canadians are prevented, by contribution and benefit limits, from using the retirement savings system to fully maintain their standards of living.*"

Source: Troubled Tomorrows

Canadian Institute of Actuaries, January 1995

Nevertheless, there is no reason to assume that the limits placed on retirement savings by the *Income Tax Act* (Canada) do not reflect reasonable public policy. Therefore, it is submitted that the Uniform Law Conference should reject considering an exemption policy for retirement income which goes beyond the money held in RPPs, RRSPs, and DPSPs as recognized in the ITA. This would of course mean the exclusion from such a policy of personal savings held outside of those vehicles, even where an individual might legitimately argue that the savings are intended for retirement income purposes.

Conversely, placing a dollar limit on the amount of retirement savings held in RPPs, RRSPs and DPSPs which is exempt from execution could only be justified on the grounds that a debtor/plan holder should suffer a decline in his or her standard of living in retirement. The tax system is designed to encourage the orderly accumulation of savings for retirement over a tax payer's working life to provide sufficient retirement income to maintain their standard of living in retirement. It is submitted that an exemption policy should respect this objective.

3. The rules governing the taxation of retirement savings were significantly changed in 1991. One of the major objectives of that reform was to equalize the retirement savings opportunities of Canadians, whether that savings is done through a RPP, an RRSP, a DPSP or some combination thereof. Prior to the reform, the tax system was skewed in favour of members of defined benefit registered pension plans. From the current tax policy perspective, a dollar held in a RPP is the same as a dollar in an RRSP.

The same cannot be said at the provincial level. Although pension plans have been in existence for over 100 years, registered pension plans were not regulated at the provincial level until Ontario, Québec, Alberta and Saskatchewan introduced legislation in the mid-to-late 1960's. Now, however, all provinces except Prince Edward Island have pension benefits standards legislation. The federal government also has such legislation for certain federally-regulated industries such as banking and transportation.

The purpose of pension benefits standards legislation is:

- To establish minimum standards, such as in regards to vesting and survivor benefits, within a pension plan with the intention of promoting the equitable treatment of members.

- To protect by regulation and supervision the benefit entitlements of beneficiaries which have been entrusted to the plan's administrator. Regulations with respect to funding, disclosure, and investments ensure the prudent operation and financial soundness of pension plans.

Provincial governments have the jurisdiction to regulate registered pension plans as a matter of property and civil rights in the province. Provincial governments have the desire to regulate registered pension plans because employers exert considerable influence over the operation of pension plans and the money contributed to a pension plan represents the deferred wages of employees. Governments regard the risk of plans failing to pay accrued pension entitlements as needing to be managed.

Provincial governments generally have not regulated RRSPs, although New Brunswick has made an effort to regulate group RRSPs under its pension benefits standards legislation. Several factors have been suggested as to why provincial governments are not regulating RRSPs:

- the use of group RRSPs as a substitute for an RPP is a relatively recent phenomenon;
- governments recognize the cost of regulation borne by RPPs and the role that the cost has played in the stagnation in the growth of RPPs; and
- the risk to employees is not as great. Unlike RPPs, an employer has no role in the administration of a group RRSP and employer contributions vest immediately and unconditionally in an employee.

Pension benefits standards legislation uniformly provides that pension money is exempt from execution, seizure or attachment. It is submitted that the absence of similar protection for RRSP money should in no way be presumed to reflect an active policy choice on behalf of provincial jurisdictions. Indeed, to the contrary, provincial recognition of the fundamental change to the *Income Tax Act* (Canada) in 1991 with respect to RPPs, RRSPs and DPSPs is only now occurring. The parity shown in the treatment of RPPs, RRSPs and DPSPs by the *Income Tax Act* (Canada) is a compelling national policy direction which should be recognized by provincial jurisdictions. The *Income Tax Act* (Canada) has recognized the need to promote retirement income savings through significant tax incentives and careful regulation. To extend provincial exemption protection to RPPs only fails to adequately reflect this important initiative. It is therefore **recommended** that the existing exemption from exigibility for RPPs be extended to all RRSPs and DPSPs.

Recommendation #1: That the existing exemption from exigibility for RPPs be extended to all RRSPs and DPSPs.

B. The protection of dependants named as beneficiaries under plans from access by creditors to plans after the death of the plan holder/debtor

At first blush, the intuitive response to the existing vagaries in exigibility between pensions, RRSPs/DPSPs and insurance contracts is that these instruments should receive equal treatment under the law. Upon further consideration, however, it is submitted that insurance contracts should be recognized as substantively different instruments than pensions and RRSPs/DPSPs and, therefore, as deserving separate policy consideration from these retirement income protection instruments.

Insurance contracts are, on a more or less uniform basis, held to be exempt from exigibility where a beneficiary from a narrow pool of family members has been selected. The primary policy basis for this exemption is submitted to be that these funds are no longer those of the debtor and that, in law, they have passed to the designated beneficiary upon election. It has been suggested that this relatively narrow rationale for exempt status may be subject to abuse by the wide array of instruments currently residing under the "insurance contract" umbrella or by the ability to revoke a previous designation of beneficiaries. Without question, these are valid topics for further analysis. Such an analysis will not, however, be pursued within the context of this paper as, for the reason briefly stated below, it is not determinative or even partially illuminative of our stated goal of addressing an exemption for retirement income.

It is submitted that the extent to which RRSPs/DPSPs (without an insurance component) and pensions provide security to the plan holders' dependants differs substantially from the protection received by those named as dependants in an insurance contract. Perhaps, more importantly, it does not differ substantively from dependants named as beneficiaries for a wide array of other instruments such as bank accounts. General investments, bank accounts and even the family home all to a degree represent the assets which a debtor "intends" to benefit his or her dependants or beneficiaries. While it may be axiomatic that the debtor would prefer all of his or her assets to be transferred directly to his or her dependants, the distinction with a difference with an insurance contract is that the transfer of funds has, in fact, already occurred at the point of election of the beneficiaries well prior to execution or bankruptcy proceedings.

In contrast, pensions, which also include designated beneficiaries, receive their current exempt status on the primary policy basis that these funds are protected for the purpose of providing retirement income for the plan holder. This protection goes to great lengths to ensure that the funds are not dissipated prior to retirement age and, even at that point, the funds are receivable on an annuity basis only. If we are looking for an analogous instrument to RRSPs/DPSPs, it is submitted that pension instruments serve as a far preferable model to insurance contracts. Pensions are currently protected from exigibility for the benefit of the debtor's retirement income. Insofar as RRSPs/DPSPs legitimately serve the same function, they too deserve exemption.

It is acknowledged that to the extent that RRSPs may be offered as "insurance contracts", these policy rationale may overlap. In such cases, insurance contracts that meet the eligibility criteria for RRSPs under the *ITA* will, in effect, be "doubly" exempt from exigibility. Beyond this narrow point of intersection, however, the policy foundation for these instruments sharply diverge. It is therefore **recommended** that the designation of beneficiaries in the context of an RRSP/DPSP should in no way be determinative of its exempt status.

Thus, notwithstanding the desirability of "treating all three instruments equally", in this context it is submitted that the Aristotelian concept that equality can only be achieved where equals are treated equally and unequals are treated differently has immediate application. For the reasons outlined above, insurance contracts will, for the purpose of this analysis, remain largely unaddressed.

Recommendation #2: That the designation of beneficiaries in the context of an

RRSP/DPSP should in no way be determinative of its exempt status.

C. The administrative burden and costs to third parties including other plan members and the tax implications to plan holders/debtors resulting from the premature termination of plans by creditors:

One of the major concerns expressed in the Alberta commissioners' consultation with respect to future income security instruments was the cost which third parties incurred as a consequence of creditor enforcement against RRSPs/DPSPs. These perceived costs ranged from increased administrative costs to other plan holders or trustees to the risk of express penalties incurred by the plan or plan holders for the removal of funds prior to the contracted date for the collapse of that investment.

Also of concern were the potentially harsh tax consequences to the plan holder for the premature withdrawal of funds from their protected tax status. This debate has been heightened in the pension community with some recent exceptions to the general exemption against exigibility which has been provided to the enforcement of maintenance orders.[7]

To a large extent these issues are entirely avoided by the exemption from exigibility of RRSPs/DPSPs. This would not necessarily be the case, however, if the choice for an exemption was limited to a specific dollar amount for annual deposits or to a stated aggregate amount. Where the funds exceeded these limits, the concerns expressed above regarding third party costs and tax consequences to the plan holder/debtor would be reinvigorated.

It is therefore **recommended** that an exemption of RRSPs/DPSPs from creditor exigibility be structured to avoid unnecessary administrative costs to third parties and, where possible, excessive tax consequences to the debtor/plan holder.

Recommendation #3: That an exemption of RRSPs/DPSPs from creditor exigibility be structured to avoid unnecessary administrative costs to third parties and, where possible, excessive tax consequences to the debtor/plan holder.

D. The use of plans by plan holders/debtors for the purpose of avoiding their responsibility to pay their creditors

An integral aspect of the establishment of a fair and defensible exemption from exigibility for RRSPs/DPSPs is that it not be subject to abuse. In our context, the opportunity for the abuse of such an exemption can be presumed to occur both before and after execution or bankruptcy.

1. Pre-Execution or Bankruptcy:

The concern regarding the abuse of exempt RRSPs/DPSPs prior to execution or prior to bankruptcy proceedings can be stated as the ability of a debtor/plan holder to avoid his or her creditors by placing large amounts of money into such a protected fund as a calculated method of avoiding creditors. This is, of course, a valid concern in light of the balance which we are seeking to strike between the legitimate goals of creditors to recoup their funds and the protection proposed by an exemption for retirement income. It is also a pivotal consideration for creditors, and particularly for unsecured creditors, with respect to the continued availability of credit.

It is submitted, however, that the existing body of statute and common law provides a more than adequate response to this express concern. Both the provincial and federal jurisdictions provide express statutory protection for creditors with respect to this issue. Provincially, fraudulent preference, fraudulent conveyance, absconding debtor legislation and the Statute of Elizabeth as well as omnibus creditor's remedies legislation such as that recently introduced in Alberta, speak directly to the ability of a creditor to overturn a transaction by the debtor that occurs in anticipation and avoidance of execution.[8]

This provincial legislation serves to overturn such a transaction and effectively negate any claim for exempt status. At common law, the equitable remedy of a mareva injunction serves a similar function.

Federally, in addition to receiving the benefits of the provincially relevant legislation noted above to negate the application of any exemption, the *Bankruptcy and Insolvency Act* provides its own well-established protection against fraudulent preferences, fraudulent conveyances and settlements.[9] While it is acknowledged that with the Ramagotra decision, this body of law is not entirely settled, at least in academic circles, it is a substantial and substantive established framework of protection against abuse of exemptions by debtors.[10]

It is, accordingly, **recommended** that no further legislative amendments to existing statutory provisions are required to ensure the adequate protection of creditors with respect to pre-execution or bankruptcy abuse.

Concomitant to the concern expressed by creditors that debtors not be able to manipulate the exemption process is the concern that inordinately large amounts of funds can be "salted away" in these exempt funds simply as a matter of routine estate planning rather than active avoidance as contemplated above.

For the reasons outlined below, it is **recommended** that no express dollar limits are required or desirable with respect to an RRSP/DPSP exemption.

Unlike, for example, a non-RRSP insurance contract instrument, the amount which can be annually placed in an RRSP/DPSP is carefully regulated. The *Income Tax Act* (Canada) provides that a person may contribute up to 18% of earned income in the prior calendar year, currently subject to a maximum of $13,500. For a member of a RPP, the RRSP/DPSP contribution room is reduced by the value of RPP benefits. That over time this amount can be substantial does not negate the validity of the policy basis for protecting such retirement income from exigibility. Those individuals who have, at the invitation on the national tax system, forgone immediate lifestyle improvements such as cars, houses and clothing in favour of careful annual savings should be protected rather than punished for their efforts.

As previously described, the limited dollar amount on annual contributions is arrived at in the federal *Income Tax Act* as a matter of careful consideration by the federal government of both what is required for adequate retirement savings and what is an acceptable amount of income to be deferred from an income tax perspective.

Rather than second-guess this amount by placing a gross cap on the amount which could be within an exemption, it is submitted that the existing limits be respected as appropriate regardless of the total amount accumulated over a number of years. This *Income Tax Act* based self-regulatory aspect of an RRSP/DPSP is much to be preferred over the artificial capping of the exemption with a dollar value that would necessarily have to accommodate regional disparities in cost of living and estimates of average lifespan/annual retirement incomes as well as to anticipate inflation and deflation. It would also require a significant degree of administrative governance to monitor. The need to avoid the unintended cost implications to third parties and the harsh tax implications for the debtor/plan holder created by this approach have been identified earlier within this paper.

Thus, what is contemplated with respect to the risk of pre-bankruptcy abuse by debtors is:

- the application of the existing, well established framework of provincial and federal *Bankruptcy and Insolvency Act* provisions regarding preferences, conveyances and settlements; and
- the recognition of the operation of the *Income Tax Act* (Canada) such that no dollar limit on the amount of funds held in exempt RRSPs/DPSPs would be required.

Recommendation #4: That no further legislative amendments to existing statutory provisions are required to ensure the adequate protection of creditors with respect to pre-execution or bankruptcy abuse.

Recommendation #5: That no express dollar limits are required or desirable with respect to an RRSP/DPSP exemption.

2. Post-Execution or Bankruptcy:

The concern regarding the abuse of exempt RRSPs/DPSPs after execution or post discharge in bankruptcy proceedings can in turn be stated as the ability of a debtor/plan holder to claim the exemption during such proceedings on the basis that the funds are to be used for retirement and then to draw down such funds prior to retirement for alternative purposes. If saving for retirement is held to be a higher priority than allowing creditors to recover a debt owed them, then it is not unreasonable to expect that governments and creditors should have some assurance that the savings objective will be met.

A significant proportion of RRSP money is used for purposes other than to provide retirement income. In 1994, 700,000 tax filers under age 65 withdrew almost $3.9 billion from RRSPs (not including withdrawals under the Home Buyers' Plan). Plan holders cashed in about one dollar for every five dollars contributed. This represents increases of 96,000 individuals and $700 million (+22%) over 1991 levels.[11]

It is difficult to determine how the withdrawals were used. About 35% of the total was withdrawn by those between 55 and 64. We could speculate that they may have needed these savings to bridge them until becoming eligible for C/QPP benefits, OAS payments and RPP pensions.

As well, because these figures do not include persons cashing in RRSPs to make down payments on a house under the Home Buyers' Plan, it is safe to assume that a significant proportion of the withdrawals were made out of financial need, as opposed to being used to purchase another asset. Most self-employed persons, for instance, do not participate in the Employment Insurance program and could be using an RRSP as an income smoothing device. These are common and attractive uses for RRSPs which should be respected and accommodated in the development of an exemption for RRSPs held for retirement purposes.

The fact that alternative uses for these "retirement" funds are already common begs the serious question of whether such early withdrawal would increase further with the added incentive of exemption from exigibility for RRSP funds? For whatever purpose the funds are used, the amount of money withdrawn from RRSPs prior to age 65 compels a discussion of the "locking in" of an RRSP/DPSP as a condition of exemption.

In the context of pension benefits standards legislation, "locked in" means that a person entitled to a pension may not withdraw or surrender during his or her lifetime any pension, any interest in a pension or any commuted value of a pension.[(12)] Therefore, locking in not only ensures that pension money will be an asset at the commencement of a plan member's retirement, it also ensures that the asset is converted to a stream of income to be paid to the plan member for as long as the member lives.

Several options have been identified with respect to when and how a lock in of RRSP/DPSP funds could occur:

- the plan holder could elect to lock in the money at the time the RRSP/DPSP is opened as part of the contract constituting the RRSP/DPSP;
- the plan holder could elect to lock in the money at the time of execution in the process of identifying exemptions;
- the courts could lock in the money in the RRSP/DPSP on application from the debtor or a creditor or as a condition of discharge; and
- legislators could provide a statutory lock in similar to that provided by pension benefit standards legislation.

Locking in RRSPs/DPSPs can have several disadvantages depending on the option taken:

1. A full statutory lock in must be administered by the financial institution, by the government or by both as shown in the administration of pension benefits standards legislation. In the context of RRSPs as currently defined under the *ITA* , this would require tracking of a broad variety of interprovincial and international investments which are readily moved between financial institutions as well as divided and commingled between several RRSPs and DPSPs.

2. Locking in at time of purchase, particularly on a non-elective basis, makes the RRSP/DPSP less attractive for sellers and buyers. Removing the flexibility of early withdrawals may have the unintended result of reducing the amount of retirement savings. It would certainly negate the use of RRSPs by self-employed individuals and others as an income smoothing device.

3. Lock in by court application risks creating a new legal industry for RRSP/DPSP related applications to Court by debtors or creditors and invites disparities in results between jurisdictions.

4. Designation by the debtor of the RRSP as exempt and therefore locked in at the time of execution creates a risk of affecting the availability of credit in non-purchase money lending situations. Faced with the potential but unpredictable withdrawal of a significant portion of the exigible assets, the creditor may chose to avoid such uncertainty and instead forgo lending in that circumstance.

5. In each of the above noted options, consensus would have to be reached on administrative details such as earliest retirement age and retirement income options. Pension benefits standards legislation is often criticized for its lack of uniformity.

The challenge therefore is to identify an option which can address the equity argument fairly raised by creditors without creating either an expensive bureaucracy for the private institutions and government institutions concerned or compelling creditors or debtors to engage in an expensive and time consuming court procedure. This option should also avoid gutting the flexibility and therefore the desirability of the RRSP as a popular savings instrument, and, perhaps above all else, it must avoid drastic impacts on the availability of credit.

The alternatives discussed above all would lock in by statute or contract. A less direct method of locking in is to use a conditional exemption as a disincentive to collapsing RRSPs/DPSPs. Under this alternative, locking in would be encouraged by binding an exemption to the maintenance of RRSP/DPSP status under the *Income Tax Act* (Canada). In other words, money in an RRSP/DPSP would be exempt as long it is held in the RRSP, but any cash payments on the collapse of an RRSP/DPSP would be subject to execution, whenever that payment is made.

It should at this point be noted that the post execution or bankruptcy abuse issue is not unique to the proposed RRSP/DPSP exemption. Current law does not prohibit the conversion of previously "exempt" assets by the post execution debtor or discharged bankrupt. In many cases such as home quarters, principal dwellings, farming or fishing equipment the dollar amounts upon conversion can be significant. As well, since RRSPs/DPSPs cannot be assigned pursuant to the *Income Tax Act* (Canada), it can be argued that few institutional creditors would have a legitimate expectation of the repayment of debt from RRSP/DPSP money. An RRSP/DPSP cannot effectively be pledged as security and accordingly creditor access is incidental rather than direct and such an exemption should not negatively effect the availability of credit.

Nevertheless, in recognition of the need to demonstrate fairness and to provide further creditor comfort regarding post execution or bankruptcy abuse, it is **recommended** that the exemption of the money in an RRSP/DPSP from exigibility be bound to the maintenance of that status under the *Income Tax Act* (Canada). This could be achieved definitionally and supported through an amendment to the *Bankruptcy and Insolvency Act (BIA*) which would make continued RRSP/DPSP status for the exempted funds a statutory condition of discharge. Early withdrawal of said funds would annul the order of discharge and therefore reinvigorate the bankruptcy proceedings and the extinguished debt in the same fashion as the discovery of post discharge fraud by the discharged debtor.[(13)] To simplify the role of the creditor in monitoring such abuse, the Act could further provide for a positive duty on a discharged bankrupt to report such early withdrawal. By providing for the annulment of the order of discharge in a case of early withdrawal, the potentially onerous task of monitoring such transactions would become an aspect of the operation of law. It would thus become a case by case assessment of commercial viability by the creditor as to whether maintaining pursuit of the debt was financially worthwhile or whether it should be written off and abandoned.

In the case of execution proceedings outside of bankruptcy, such additional restrictions are of course not required. Judgment debtors who remain unsatisfied post execution already have the ability to maintain their writs against the subsequent conversion of previously exempt assets where they deem it economically viable to do so. Bankruptcy proceedings may however merit this special consideration in light of the manner in which such proceedings extinguish the debt in question in its entirety.

In summary, it is proposed that the issue of post bankruptcy or execution abuse be addressed by restricting the locking in of RRSP/DPSP money as a condition of receiving protection from creditors to lock in by the *Income Tax Act* (Canada) status only.

It is **recommended** that the BIA be amended to include continued RRSP status for such funds as a condition of discharge, to impose a positive duty on a debtor to report early withdrawal of exempt funds, and to provide for the annulment of an order of discharge where the discharged bankrupt accesses such funds prior to the ITA restrictions (eg. prior to age 65).

Recommendation #6: That the exemption from exigibility of the money held in an RRSP/DPSP be bound to the maintenance of that status under the *Income Tax Act* (Canada).

Recommendation #7: That the BIA be amended to include continued RRSP status for such funds as a condition of discharge, to impose a positive duty on a debtor to report early withdrawal of exempt funds, and to provide for the annulment of an order of discharge where the discharged bankrupt accesses such funds prior to the ITA restrictions (eg. prior to age 65).

III ADDITIONAL CONSIDERATIONS

1. Retirement Income

With the adoption of the recommended exemption it becomes necessary to further consider the issue of exigibility at the wind down of the RRSP/DPSP under the *Income Tax Act*(Canada). An RRSP/DPSP may be collapsed at any time, but must be collapsed prior to the end of the calendar year in which the plan holder attains age 69. In addition to taking the money as a lump sum payment, the funds also may be used to purchase a life or term certain annuity or can be transferred to a registered retirement income fund (RRIF).

It would appear anomalous to take great pains to prevent the seizure of retirement savings up to the point of payment and then take a hands off approach which would allow for the wholesale dissipation of those amassed funds at retirement. Pension benefits standards legislation is, however, particularly instructive in this regard. Upon maturation of the pension entitlement, the plan holder is limited to the receipt of a fixed annuity.[(14)] While the lump sum in the pension plan remains exempt from exigibility, in some recent cases the individual payments themselves have been held to be subject to exigibility upon payment (subject it is presumed to the debtor's remaining applicable exemptions).[(15)] Thus the carefully accumulated principal is not squandered while the immediate needs of the debtor remain protected by applicable provincial exemptions. In turn, the creditor would on this analysis be entitled to execution on that portion of the funds as they are paid out that are not considered essential by applicable exemption law for the minimal well being of that debtor.

In the context of the proposed RRSP/DPSP exemption, what is therefore **recommended** is that upon maturation of the RRSP/DPSP under the *Income Tax Act* (Canada), the exemption should be extended to a RRIF based on those exempt funds. It is further **recommended** that the payments under the RRIF would themselves be exigible subject to applicable exemptions law. The bulk of the funds would however remain protected as long as they retain RRIF status. An alternative option for the debtor/plan holder would be to retain the exempt status of the RRSP/DPSP funds through conversion to an insurance annuity which would of course already enjoy a similar exemption. It is submitted that this approach is consistent with the overall policy basis for the exemption of protecting a reasonable income stream for debtors upon retirement. If however the funds are drawn out of the RRSP, DPSP, RRIF or insurance annuity contract they would and should be subject to exigibility.

Recommendation #8: That upon maturation of the RRSP/DPSP under the *Income Tax Act*(Canada), the exemption should be extended to a RRIF based on those exempt funds.

Recommendation #9: That the payments under the RRIF would themselves be exigible subject to applicable exemptions law.

2. Exceptions

It is necessary to acknowledge that as compelling as the policy argument in favour of the proposed exemption is submitted to be, it may be appropriate that this exemption should itself fall subject to certain exceptions. RPP legislation in Canada is currently divided on the extent to which maintenance enforcement efforts are to be considered as an exception to the general exemption from exigibility for these instruments.[(16)]

Persuasive arguments can also be made that judgment creditors in cases of criminal restitution, victims of domestic violence, consumer protection and professional liability, to name only the most obvious, deserve policy protection in preference to that intended for the plan holder as retirement income.

However, as the RPP debate with respect to maintenance enforcement has shown, exceptions to a general exemption can create unintended administrative burdens for third party plan holders as well as for the plan holder/debtor.[(17)] Simplicity and uniformity are key elements to the recommendation for an exemption from exigibility for RRSPs/DPSPs/RRIFs and they should not be sacrificed without considerable thought and consultation.

Accordingly, it is **recommended** that the Uniform Law Conference direct that further study be made on the issue of potential exceptions to the proposed exemption from exigibility for RRSPs/DPSPs/RRIFs. The recent enhancements to the restitution provisions of the *Criminal Code* and the increased adoption of civil victims of domestic violence legislation would appear to dictate reconsideration of this issue beyond the scope of maintenance enforcement. It is also recognized that the recognition of preferred status for these types of interests in this context clearly begs the question of whether similar preference is to be provided in considering other existing exemptions. Currently, exemptions vary widely between provincial jurisdictions and it may well be preferable to allow local choices to be made with respect to the prioritization of these competing interests.

Recommendation #10: That the Uniform Law Conference direct further study of the issue of what, if any, exception(s) should be recognized to the proposed exemption from exigibility for RRSPs/DPSPs/RRIFs.

3. Transition Issues

Consideration must be given as to whether the exemption would apply to:

(a) all debt and all RRSPs/DPSPs;

(b) new debt and new RRSPs/DPSPs only;

(c) all debt and new RRSPs/DPSPs only; or

(d) new debt only and all RRSPs/DPSPs.

Applying an exemption to all debt and all RRSPs/DPSPs has simplicity on its side, but would frustrate the legitimate expectations of existing creditors and would be disruptive to current proceedings. Simply put, actions may not have been commenced and funds may not have been advanced if it had been known that this exemption would apply. As well, it is generally held that where possible the retroactive application of legislation is to be avoided.

The issue of retroactive application would be avoided by the new debt, new RRSP/DPSP model. For the sake of discussion, new debt will be defined as meaning debt incurred after the proclamation of exemption legislation (including judgment debt). New RRSPs/DPSPs would mean either (1) contributions, and investment earnings on those contributions, made after the proclamation of exemption legislation or (2) contributions, and investment earnings on those contributions, made after proclamation as well as investment earnings earned after proclamation on contributions made prior to proclamation.

The weakness of an exemption for new debt and new RRSPs/DPSPS is in its execution. Unless a relatively complicated scheme is legislated and administered, it would be difficult to control the exemption. Financial institutions would have to track new RRSPs/DPSPs separately from old RRSPs/DPSPs. Under the *Income Tax Act* (Canada), a plan holder can contribute to an existing RRSP/DPSP, commingle RRSPs/DPSPs, divide an existing RRSP/DPSP into several RRSPs/DPSPs, and move RRSP/DPSP money across provincial and international borders and between financial institutions. The probability that mistakes would not occur is low or would come at a significant cost.

It of course follows from the above noted analysis that the "all debt, new RRSPs/DPSPs" combines the "worst of both worlds" and is accordingly to be avoided.

It is therefore **recommended** that the new debt only and all RRSPs/DPSPs alternative provides an acceptable balance between fairness and practicality in the transition to the proposed exemption. This alternative avoids complicated and expensive tracking requirements for old and new RRSPs/DPSPs funds as well as any need for retroactive application in the consideration of pre-existing debts. Uniform proclamation dates for the proposed exemption between provincial jurisdictions would of course provide the most seamless transition to the new provisions.

Recommendation #11: That the exemption from exigibility would apply to all funds held in all RRSPs/DPSPs, but only with respect to debt incurred after the proclamation of the implementing legislation.

4 **Consultation**

As noted from the outset, creditor access to future income security plans is a complex issue which presents a variety of difficult policy choices. The recommendations contained in this report are intended to assist in the consideration of this issue and to focus the debate on these choices. The Alberta commissioners, in first addressing this issue, conducted a broad ranging consultation with a wide array of stakeholders. The recommendations presented in this report have not enjoyed the benefit of similar scrutiny. It is submitted as appropriate if not essential that these or any alternative or additional recommendations be circulated to this consultation group for their input prior to proceeding with the preparation of a Uniform Act.

Recommendation #12: That the Uniform Law Conference direct that consultations be conducted on a proposed exemption from exigibility for future income security plans that would have the following constituent elements:

(a) The extension of the exemption from exigibility of RPPs to RRSPs and DPSPs;

(b) That funds held in RRSPs and DPSPs would enjoy the protection of this exemption only so long as they retain their status as RRSPs and DPSPs under the *Income Tax Act (Canada*);

(c) That the *Bankruptcy and Insolvency Act* be amended to provide that continued RRSP/DPSP status under the *ITA* is a statutory condition of discharge for any bankrupt who utilizes this exemption and that failure to comply with this condition would annul the order of discharge and re-establish the debt;

(d) That the exemption from exigibility be extended to an RRIF based on these exempt funds;

(e) That any payments out of an exempt RRIF would be subject to exigibility; and,

(f) That the exemption would apply to "new debt" only on all RRSPs and DPSPs.

IV SUMMARY OF RECOMMENDATIONS

Recommendation #1: That the existing exemption from exigibility for RPPs be extended to all RRSPs and DPSPs.

Recommendation #2: That the designation of beneficiaries in the context of an RRSP/DPSP should in no way be determinative of its exempt status.

Recommendation #3: That an exemption of RRSPs/DPSPs from creditor exigibility be structured to avoid unnecessary administrative costs to third parties and, where possible, excessive tax consequences to the debtor/plan holder.

Recommendation #4: That no further legislative amendments to existing statutory provisions are required to ensure the adequate protection of creditors with respect to pre-execution or bankruptcy abuse.

Recommendation #5: That no express dollar limits are required or desirable with respect to an RRSP/DPSP exemption.

Recommendation #6: That the exemption from exigibility of the money held in an RRSP/DPSP be bound to the maintenance of that status under the *Income Tax Act* (Canada).

Recommendation #7: That the BIA be amended to include continued RRSP status for such funds as a condition of discharge, to impose a positive duty on a debtor to report early withdrawal of exempt funds, and to provide for the annulment of an order of discharge where the discharged bankrupt accesses such funds prior to the ITA restrictions (eg. prior to age 65).

Recommendation #8: That upon maturation of the RRSP/DPSP under the *Income Tax Act*(Canada), the exemption should be extended to a RRIF based on those exempt funds.

Recommendation #9: That the payments under the RRIF would themselves be exigible subject to applicable exemptions law.

Recommendation #10: That the Uniform Law Conference direct further study of the issue of what, if any, exception(s) should be recognized to the proposed exemption from exigibility for RRSPs/DPSPs/RRIFS.

Recommendation #11: That the exemption from exigibility would apply to all funds held in all RRSPs/DPSPs, but only with respect to debt incurred after the proclamation of the implementing legislation.

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(a) The extension of the exemption from exigibility of RPPs to RRSPs and DPSPs;

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(c) That the *Bankruptcy and Insolvency Act* be amended to provide that continued RRSP/DPSP status under the *ITA* is a statutory condition of discharge for any bankrupt who utilizes this exemption and that failure to comply with this condition would annul the order of discharge and re-establish the debt;

(d) That the exemption from exigibility be extended to an RRIF based on these exempt funds;

(e) That any payments out of an exempt RRIF would be subject to exigibility; and,

(f) That the exemption would apply to "new debt" only on all RRSPs and DPSPs.

1. *Population Aging and the Elderly*. Statistics Canada, Catalogue 91-533E., 1993

2. *Troubled Tomorrows*. Canadian Institute of Actuaries, January 1995

3. *Troubled Tomorrows*. Canadian Institute of Actuaries, January 1995

4. *Canada's Retirement Income Programs*. Statistics Canada, Catalogue No. 74-507-XPB, 1996

5. *RRSP contribution limit (room)*. Statistics Canada, The Daily, December 1996

6. *Pension Reform: Improvements in Tax Assistance for Retirement Saving*. Department of Finance, 1989

7. *Manitoba and Saskatchewan amended legislation in 1995 and 1996, respectively, to allow the attachment of pension entitlements for purposes of enforcing maintenance orders.*

8. *See, for example, The Civil Enforcement Act, S.A. 1994, c. C-10.5, proclaimed in force on January 1, 1996; The Fraudulent Preferences Act, R.S.S. 1978, c. F-21; The Fraudulent Conveyances Act , R.S.O. 1990, c. F.29; The Absconding Debtors Act, R..S.N.B. 1973, c. A-2.*

9. *ss. 91-93 BIA re: settlements and fraudulent conveyances; ss.95-96 BIA re: fraudulent preferences.*

10. *Royal Bank of Canada v. North American Life Assurance Co. And Balvir Singh Ramgotra, 132 D.L.R.(4th) 193 (S.C.C.); see also "Section 91 (Settlements) of the Bankruptcy and Insolvency act: A Mutated Monster", R.C.C. Cuming, (1995), 25 C.B.L.J. 235, and "Prebankruptcy Settlements: Royal Bank of Canada v. North American Life Assurance Co. And Balvir Singh Ramgotra", L.K. Caplan, (1996), 27 C.B.L.J. 458.*

11. *RRSP Withdrawals Revisited. Statistics Canada, The Daily, December 1996*

12. *See, for example: s.63, The Pension Benefits Act, R.S.O.; s.30 The Pension Benefits Standards Act, R.S.B.C.; s.27, The Employment Pension Plans Act, R.S.A.;s.29, The Pension Benefits Act,1992, R.S.S..*

13. *Subsection 180(2) of the BIA authorizes the court to annul a discharge obtained by fraud.*

14. *See, for example: ss.36, 37 and 63, The Pension Benefits Act, R.S.O.; ss. 26 and 30 The Pension Benefits Standards Act, R.S.B.C.; ss.23 and 27, The Employment Pension Plans Act, R.S.A.; ss. 27 and 29, The Pension Benefits Act,1992, R.S.S..*

15. *See for example: 2176, SOQUILJ J.E. 95-907, Quebec Court of Appeal, where once made, the payments were held to be part of the debtor's estate and therefore subject to exigibility under the Code of Civil Procedure. See also M.J.R.v. A.R., [1995] A.J. No.287, Alberta Queen's Bench , as an example of the use of an equitable receiver to avoid the legal restriction on exigibility of pension funds.*

16. *See supra, note 7, at 11.*

17. *See discussion under heading II, C, supra, at 10.*