

# Insolvency and Restructuring Bulletin

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## RRSPs and RRIFs in Bankruptcy: Policy and Practical Pitfalls in the Proposed Amendments

As discussed in *Exemptions of RRSPs and RRIFs in Bankruptcy: Bill C-62 Will Change the Changes Made by Bill C-55*, Bill C-62 (if passed and proclaimed in force) will affect RRSPs and RRIFs in two ways:

1. RRSPs and RRIFs that are based on annuities issued by life insurers and immune from creditor seizure under provincial laws will be beyond the reach of a bankruptcy trustee.
2. RRSPs and RRIFs that are not protected by provincial laws will be beyond a bankruptcy trustee's reach save for contributions made in the 12 months immediately preceding bankruptcy (the "clawback").

There are three notable scenarios in which the proposed treatment of RRSPs and RRIFs under Bill C-62 may raise questions.

### Scenario 1: Lump Sum Contributions

Imagine that "X" is a member of an employer-sponsored pension plan that is exempt from seizure under provincial laws (as most pension plans are) and the employer terminates the plan, entitling X to a commutation payment. Typically, such a lump sum will be paid directly into a locked-in RRSP for X. If the RRSP is

subject to the clawback, the full value of the commutation payment is exposed should X become bankrupt within 12 months.

Should such commutation payments be subject to the clawback? They often represent years of contributions, sometimes exclusively made by the employer and not funded from assets of the employee. If the decision to wind-up the plan is that of the employer, should X's retirement income be exposed because of that decision? What alternatives did X have? Should X have spent the commutation payment prior to bankruptcy, leaving his creditors in no different position than if the pension plan had not been wound up or the commutation payment was used to purchase a locked-in RRSP from a life insurance company? By way of comparison, under Bill C-62 a non-arm's length "transfer at undervalue" (a transfer that prejudices the creditors), made within the same 12 month period, can only be challenged where the bankrupt was insolvent at the time (or was rendered insolvent thereby). No such condition would apply to the clawback and nothing in Bill C-62 confers discretion on a bankruptcy trustee or the courts to override the non-exempt status of contributions subject to the clawback.

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### Scenario 2: Third Party Contributions

Where Spouse1 makes contributions to a non-life insurance RRSP of Spouse2, and Spouse2 becomes bankrupt within 12 months, such contributions will be subject to the clawback. The clawback will also apply where an employer makes contributions to a non-life insurance RRSP for an employee as part of the employee's package of wages and benefits.

Nothing in Bill C-62 considers the source of the funds contributed to a bankrupt's RRSP. While gifts received from a spouse (or others) generally are counted among the assets of a bankrupt estate, should this be the case with government-sanctioned investment vehicles funded from assets that did not belong to the bankrupt? Should the clawback apply where an employer contributes to an employee RRSP not at the request of the employee but because it is part of a standard package of wages and benefits?

### Scenario 3: Locked-in Contributions

Where contributions to a non-life insurance RRSP are locked-in, either because the plan is locked-in or because it contains long term instruments (e.g., GICs not redeemable before maturity), it is unclear how the bankruptcy trustee may be able to enforce the clawback.

Will the bankruptcy trustee be able to "unlock" (say) a fixed term deposit held in an RRSP in order to access the non-exempt portion of the RRSP under the clawback? Could the trustee do so partially, while the bank remains bound to honour the deposit terms with respect to the remaining, exempt portions of the RRSP? Could the trustee only require the bankrupt to assign to it the right to withdraw the non-exempt portion of the RRSP when permitted? Bill C-62 does not provide guidance on any potential issues concerning how a bankruptcy trustee could (or should) proceed.

### Conclusion

It is to be hoped that the Senate Banking, Trade and Commerce Committee will consider the potential issues that are described above before Bill C-62 is passed into law.

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