THE WINDING-UP AND RESTRUCTURING ACT:

RECOMMENDATIONS FOR REFORM

A REPORT OF THE INSOLVENCY INSTITUTE OF CANADA

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1. Introduction

The *Winding-Up and Restructuring Act*[1] (the "WRA") is a frequently overlooked and often neglected element of Canada's scheme of insolvency legislation. It is important to recognize however, that the WRA is actually a key component of the legal framework that underpins the Canadian economy. This is because the WRA contains the primary set of rules that govern the affairs of most financial institutions – *i.e.* banks, trust companies, loan companies and insurance companies – experiencing financial distress. Because of the size and influence of many Canadian financial institutions, the conduct of the affairs of a troubled institution can have a significant effect upon broad sections of the economy as a whole. Consequently, the WRA deserves more attention than it has received to date from insolvency professionals and lawmakers.

This Report presents the results of a review of the WRA by experienced insolvency professionals and representatives of financial institutions and compensation corporations. Its objective is to provide a template for reform of the WRA. This effort appears to be the first of its kind in the history of the statute and seems, at least in hindsight, to be long overdue.[2]

The Report is organized as follows. The following section discusses the objectives that the WRA ought to be designed to achieve. The subsequent sections identify certain aspects of the WRA that ought to be reformed if the statute is to achieve the specified objectives. The penultimate section concludes. The final section lists the recommendations in summary form. The principal participants in the review process are listed at the end of the Report.

[1] R.S.C. 1985, c.W-11

[2] Individual portions of WRA have been revised, in some cases on a number of occasions. For instance, in 1996 Parts II and III of the WRA, which dealt with banks and insurance companies respectively, were completely overhauled. As a result Part II was repealed and Part III was significantly revised and expanded. More recently, the Federal government has enacted legislation that clarifies the application of various provisions of the WRA to foreign banks with branches in Canada and introduces an entirely new Part II of the Act to deal with such banks. See Bill C-67, *An Act to amend the Bank Act, the Winding-Up and Restructuring Act and other Acts relating to financial institutions and to make consequential amendments to other Acts*, 1st Sess., 36th Parl., Canada, 1999, ss. 76-92.

2. The purpose of the WRA

The WRA is designed to govern the liquidation and, where appropriate, restructuring of a limited set of corporations. For the purposes of this review it has been assumed that the WRA should be designed to ensure that those proceedings are conducted efficiently and equitably. This in turn implies that, generally speaking, the WRA should be designed to maximize the aggregate wealth of the creditors and shareholders of the corporations being wound up. More specifically, this implies that the WRA should be designed to ensure that:

- administrative costs incurred during the course of a liquidation or reorganization are minimized;
- the assets of the corporation being wound up are transferred to their most valuable alternative uses; and
- voluntary creditors' bargained for rights are disrupted as little as possible so as to minimize the costs of extending credit to firms.

As far as the last of these points is concerned, protecting the reasonable expectations of voluntary creditors is not only efficient but is also consistent with the notion that liquidation should proceed in an equitable fashion. On the other hand, some voluntary creditors should not necessarily benefit at the expense of other creditors who are unable to adjust the terms upon which they deal with corporations to reflect changes in their creditworthiness. Therefore, equity dictates that the legislation should provide special protection for the latter group of creditors.

It is also important to keep in mind the fact that the current WRA is designed primarily to deal with financial institutions experiencing financial distress. In that context achieving economic efficiency may involve more than simply maximizing the wealth of the creditors and shareholders of the troubled institution. This is because the failure of a financial institution may have broader systemic effects. Specifically, the failure of one financial institution may trigger the failure of other institutions in the industry. This may in turn have significant macro-economic effects.[3] Thus, the timing and the manner in which a financial institution is liquidated or restructured may affect the economic interests of many members of society besides those who have invested in the particular institution. This suggests that the WRA should permit government officials to play a significant role in at least the initiation of winding-up and restructuring proceedings.

The special characteristics of financial institutions also mean that a large proportion of their creditors tend to hold relatively small claims and to be relatively uninformed about the affairs of the firm. On the other hand, many of those customers are protected by insurance or compensation programmes offered by entities such as the Canadian Life and Health Insurance Compensation Corporation ("CompCorp") and the Canada Deposit Insurance Corporation ("CDIC"). As a result, one of these insurers or compensation providers typically has a large financial stake in any given winding-up proceeding. Those entities also tend to accumulate a great deal of expertise in the course of performing their regular functions. Consequently, it is important to ensure that the WRA permits insurers and compensation providers to play an effective role in the administration of firms being wound-up.

The remainder of this Report outlines the most significant ways in which the WRA falls short of achieving the objectives set out above and provides recommendations for reform of the statute.

3. Application

The corporations to which the WRA currently applies include but are not limited most financial institutions. However, the liquidation or reorganization of a financial institution involves very different considerations from the liquidation or reorganization of any other type of corporation. For instance, financial institutions typically have very different capital structures and types of liabilities from other types of corporations and significantly more liquid assets. In addition, the spectre of systemic risk is usually not present in the liquidation or reorganization of non-financial corporations. Ideally then,

[3] For a critical analysis of these arguments see Ronald J. Daniels, "Bad Policy as a Recipe for Bad Federalism in the Regulation of Canadian Financial Institutions: The Case of Trust and Loan Companies" (1993), 31 Osgoode Hall L.J. 543.

separate legislation should govern the liquidation and reorganization of financial institutions and non-financial institutions. This leads us to recommend that the WRA be amended to apply exclusively to financial institutions.

Amending the WRA to exclude firms other than financial institutions should cause relatively few problems. This is because in most cases the excluded corporations would continue to be able to liquidate or restructure under other legislation. In the case of an insolvent corporation that legislation would be either the *Bankruptcy and Insolvency Act* (the "BIA")[4] or the *Companies' Creditors Arrangement Act* (the "CCAA").[5] As for solvent corporations, many of them can be wound-up under either their enabling legislation, *i.e.* the legislation under which they were incorporated, or provincial winding-up legislation of general application. There are however, a few solvent corporations that would be left with no way of being wound up if they were excluded from the WRA. It will also be necessary to confront the issue of whether the list of financial institutions used in the current WRA is sufficiently broad or should be amended to include firms such as credit unions and non-financial corporations that are affiliates of financial institutions. These points are discussed in greater detail below.

Consequences of excluding insolvent non-financial corporations

Insolvent corporations that are not financial institutions but are nonetheless subject to the WRA can almost always be subject to proceedings under the BIA and CCAA. The only exceptions appear to be corporations incorporated outside of Canada that carry on business in Canada but are not authorized to do so and do not have an office or property in Canada. Some of these corporations are subject to the WRA but not the BIA.[6] This lacuna could be eliminated by a simple amendment to the BIA.

Generally speaking, forcing insolvent non-financial corporations to resort to the BIA or CCAA seems unproblematic. This is because the BIA and the CCAA are far better suited than the WRA to deal with those corporations. This assertion is based in part upon the fact that it would be inefficient to apply the WRA's administrative scheme to a

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[4] R.S.C. 1985, c. B-3

[5] R.S.C. 1985, c. C-36.

[6] Compare WRA, s. 6 and BIA s. 2 "corporation".

typical insolvent business corporation. If all of the recommendations set out below are adopted by Parliament, the WRA will still give the Court a great deal of control (relative to creditors) over the administration of a corporation being wound up. Under the BIA, creditors would have somewhat greater power. The reason for this difference is that the administrative scheme provided under the WRA seems better suited to cases in which there are a significant number of creditors who are incapable of representing their interests effectively without the assistance of the Court. This scenario is not uncommon in the case of an insolvent financial institution. However, in other cases the degree of court supervision contemplated under the WRA would be inefficient.

It is also significant that the application of the provisions of the BIA to insolvent business corporations has been judicially considered on numerous occasions. Meanwhile, the WRA has been interpreted relatively infrequently in contexts other than proceedings involving financial institutions. This suggests that resorting to the WRA to deal with an insolvent busines corporation could create costly uncertainty.

Finally, it is worth noting that the presumption that the BIA is better suited to the needs of insolvent business corporations than the WRA is implicitly endorsed in s. 213 of the BIA which bars a corporation from being wound-up under the WRA if it is already subject to proceedings under the BIA.

One concern has, however, been raised about denying insolvent non-financial corporations the option of proceeding under the WRA. There is anecdotal evidence that some foreign courts in civil law jurisdictions are more likely to recognize the actions of a liquidator appointed under the WRA than those of a trustee appointed under the BIA. The reason for this appears to be that the liquidator ostensibly acts in the name of the corporation being wound-up and exercises the powers of the corporation's board of directors without actually acquiring an interest in any of the corporation's property. By contrast, the authority of a trustee in bankruptcy to deal with the property of a bankrupt is derived from the fact that the bankrupt's property vests in the trustee by operation of law.[7] Even if it is true however, that liquidators' actions are more likely to be recognized abroad than those of a trustee this fact does not provide a justification for continuing to permit insolvent non-financial corporations to be wound up under the WRA. A more

[7] BIA, s. 71(1).

appropriate solution to this problem is to amend the BIA to authorize the court to appoint the trustee in bankruptcy as liquidator of the bankrupt corporation with power to realize any part of the bankrupt's property situated outside Canada and to exercise the powers of the board of directors of the insolvent company. This general approach was adopted in Bill C-17 (1984).

Consequences of excluding solvent non-financial corporations

Most solvent corporations that can currently be wound up under the WRA can also be wound up under their enabling legislation. Moreover, with the exception of Alberta, every province has enacted winding-up legislation that applies to all corporations incorporated by Act of the relevant provincial government.[8] Even in Alberta all general Acts under which corporations may be incorporated seem to make provision for the winding-up of the corporation. In fact, our research suggests that the only corporations whose enabling statutes do not provide for their winding-up and which are not automatically subject to provincial winding-up legislation are those incorporated under the following legislation:

- Special Acts of Parliament
- Special Acts of the Legislative Assembly of Alberta
- *Canada Corporations Act*[9]
- *Canada Cooperative Associations Act* [10]
- *Defence Production Act*[11]
- *Pension Fund Societies Act*[12]

Assuming that all of these corporations are currently subject to the WRA,[13] it will be useful to make legislative provision for their liquidation (while solvent) if the WRA is

[8] See *Company* Act, R.S.B.C. 1996, c. C-62, ss. 267-296 (British Columbia); *Companies Winding Up Act*, R.S.S. 1978, c. C-24 (Saskatchewan); *Corporations Act*, R.S.M. 1987 c. C-62, ss. 2, 200-221 (Manitoba); *Winding-Up Act*, R.S.Q. 1977, c. L-4 (Quebec); *Winding-Up Act*, R.S.P.E.I. 1988, c. W-5 (PEI); *Companies Winding Up Act*, R.S.N.S. 1989, c.82 (Nova Scotia); *Winding Up Act*, R.S.N.B. 1973, c. W-10 (New Brunswick); *Corporations Act* R.S.N. 1990, c. C-36 (Newfoundland).
[9] R.S.C. 1970, c. C-32.
[10] R.S.C. 1985, c. C-40.
[11] R.S.C. 1985, c. D-1, s. 6(1).
[12] R.S.C. 1985, c. P-8.

amended to exclude non-financial corporations. We recommend that this be accomplished by extending the scope of the provisions of the *Canada Corporations Act* that deal with winding-up and dissolution since that statute already governs many aspects of the affairs of corporations incorporated by Special Acts of Parliament.[14]

How should the WRA define a financial institution?

The WRA indicates that it applies to, among other corporations, "banks, savings banks, trust companies, insurance companies, loan companies having borrowing powers [and] building societies having a capital stock". Notably, this list does not include credit unions and so it appears that credit unions are not subject to the WRA unless they are federally incorporated. Credit unions are however, typically subject to the BIA[15] and we understand that the experience in liquidating credit unions under the BIA has been positive. On the whole, the BIA has been a cost-effective mechanism for liquidating small credit unions. On the other hand, in certain respects the WRA is better suited than the BIA for liquidating large credit unions. For example, under the WRA it is not necessary for depositors to prove their claims. Therefore, we recommend that the WRA be amended to apply to credit unions with total liabilities that exceed $100 million. The BIA should be amended so that it does not apply to these institutions.

There is also some question as to whether the WRA should apply to affiliates of financial institutions that would not independently qualify as financial institutions for the purposes of the WRA. The federal government has announced its intention to permit widely held financial institutions to operate under a regulated holding company structure.[16] A decision will clearly have to be made about what insolvency legislation will apply to various members of a group of affiliated firms that includes one or more financial institutions. However, this important issue cannot be addressed without being familiar with the entire legal framework that will govern non-financial affiliates of

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[13] It is doubtful that any Albertan Special Act corporation would even be subject to the WRA. This follows from both the language of section 6 of the WRA and the constitutional limitations on Parliament's power over solvent corporations incorporated pursuant to provincial legislation.
[14] See *Canada Corporations Act*, *supra* ss. 158-219.
[15] BIA, s. 2, "bank", subsections (b) and (c).
[16] Finance Canada, Reforming Canada's Financial Services Sector: A Framework for the Future (1999).

financial institutions. Consequently, at this point in time we are not prepared to make any recommendations on this point.

Recommendations:

- **The WRA should apply exclusively to financial institutions.**
- **The list of financial institutions to which the WRA applies should include credit unions with total liabilities that exceed $100 million.**
- **The BIA should be amended so that it does not apply to credit unions with total liabilities that exceed $100 million.**
- **The BIA should be amended to provide that a trustee in bankruptcy may be appointed as a liquidator.**
- **The Canada Corporations Act should be amended to provide for the liquidation and dissolution (while solvent) of all federal non-financial corporations currently subject to the WRA.**

4. Effect of the WRA on the Crown

Currently, the WRA does not bind the Crown.[17] This means that unlike other creditors the Crown is not bound by a stay of proceedings once a winding-up is commenced. Allowing the Crown to enforce its claims against the assets of the firm being wound up may restrict the liquidator's ability to maximize the proceeds of the liquidation by transferring assets to their most valuable alternative uses. A second potentially undesirable consequence of the fact that the WRA does not bind the Crown is that it is not possible to compromise Crown claims in the course of a restructuring. The WRA should be amended to remedy these shortcomings. This would make the WRA consistent with the BIA and the CCAA which are both binding on the Crown.

Recommendation: The WRA should bind the Crown and thus permit the stay and compromise of Crown claims in the course of winding-up and restructuring proceedings.

5. Avoidance powers

The WRA contains a number of extremely intricate provisions that permit a liquidator to attack a range of transactions consummated prior to the commencement of winding-up proceedings. These provisions are unsatisfactory in two respects. First, the provisions of the WRA that permit the avoidance of preferential transactions and contracts made with intent to defraud or delay creditors do not contain a limitation period. Meanwhile, the equivalent provisions of the BIA contain limitation periods of three months and twelve months respectively for transactions involving unrelated parties.[18] Generally speaking it is both fair and efficient to include limitation periods in provisions that permit the avoidance of previously concluded transactions. This serves to protect parties that transact with firms subject to the WRA from the losses that they might incur if their transactions are set aside. Exposing firms' trading partners to the risk of having their transactions set aside in perpetuity is inefficient as it deters prospective trading partners from dealing with potentially insolvent firms well before any conceivable benefit could flow from such deterrence.[19] The omission of a limitation period from the provision of the WRA dealing with preferential transactions is particularly troubling in this regard. The omission of a limitation period from the WRA's provision concerning fraudulent contracts is less troubling because that provision only applies to cases where the other party to the transaction is aware of the transaction's fraudulent nature.[20]

The second major problem with the avoidance powers set out in the WRA is that they are extremely difficult to understand. This is mainly because the language used in the WRA differs significantly from the language used in equivalent provisions of the BIA. For example, instead of referring to transactions made when a firm is insolvent, the

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[17] *Cf.* BIA, s. 4.1.
[18] BIA, ss. 91(1), 95. Where related parties are involved the limitation periods are one year and five years respectively: BIA ss. 91(2), 96.
[19] In theory, it might be beneficial to encourage third parties to refrain from dealing with firms that they know are on the brink of insolvency because the refusal to deal might prompt other stakeholders in the firm to take corrective measures that will stave off failure. However, this theory does not justify making it difficult to deal with firms that are further removed from insolvency. See George G. Triantis and Ronald J. Daniels, The Role of Debt in Interactive Corporate Governance (1995), 83 Cal. L. Rev. 1073.

WRA refers to transactions made "by a company in contemplation of insolvency" or by a company that is "unable to meet its engagements". There are also a number of differences between the two statutes in respect of the mental elements that must exist in order to trigger the application of otherwise similar provisions. Even if there are no substantive problems with the language used in the WRA it is sufficiently opaque to create unnecessary uncertainty for parties that transact with corporations subject to the statute. This gives rise to the possibility of both inefficient defensive practices and inequity.

In light of the above it seems worthwhile to amend the relevant provisions to conform generally to the equivalent provisions of the BIA. However, we would give the liquidator stronger powers than a trustee in bankruptcy to challenge non-arm's length transactions because the directors and managers of a financial institution probably have more opportunities to obtain personal benefits at the expense of creditors than their counterparts in other types of enterprises. Further consideration should also be given to whether it should be possible to use the avoidance powers to reverse injections of capital designed to help struggling financial institutions survive. We understand that the federal government is considering this issue in the course of its efforts to draft rules to govern holding companies for financial institutions.

Recommendation: The avoidance powers in the WRA should be amended to conform to the corresponding provisions found in ss. 91-101.2 of the BIA subject to the following exceptions:

- **The limitation period for non-arm's length preferences should be extended to 2 years.**
- **The limitation period for reviewable transactions should be extended to 5 years.**
- **For the purposes of the provisions dealing with reviewable transactions the definition of a related party should roughly correspond to the definition used in section 486 of the Bank Act.**

[20] WRA, s. 99.

6. Priorities

The main problem with the priority provisions contained in Part I of the WRA is that they are not sufficiently detailed. More specifically, the WRA makes no provision for the priority of Crown claims and only recognizes two categories of preferred claims.

These deficiencies are partially cured by the fact that special priority rules are contained in either the WRA or other legislation to govern the affairs of banks,[21] insurance companies[22] and federally incorporated trust and loan companies.[23] For instance, the *Bank Act* and the federal *Trust and Loan Companies Act* (the "TLCA") specify the priority of Crown claims, subordinated indebtedness and fines and penalties. However, the priority of such claims against insurance companies and any corporations incorporated under provincial law, including provincially incorporated trust and loan companies, remains unclear.[24] Moreover, the priority rules set out in the *Bank Act* and the TLCA are not sufficiently detailed and their treatment of Crown priorities is unsatisfactory. Therefore, it seems appropriate to amend the WRA to specify the priority of Crown claims and certain other unsecured claims in winding-up proceedings. These points are discussed at greater length in the following sections. We also discuss the anomalous treatment of certain policyholders' claims under section 161(2) of the WRA.

Crown claims

Unlike the BIA the WRA makes no special provision for Crown claims. As a result, under the WRA the Crown retains the benefit of the priority conferred by a wide array of statutory liens as well as its common law prerogative. On the other hand, Crown claims for environmental cleanup costs are not given super-priority over other claims as they would be under section 14.06(7) of the BIA.

The problems with allowing the Crown to retain the priorities conferred by its common law prerogative and statutes other than the BIA were canvassed by the Colter

[21] *Bank Act*, S.C.1991, c. 46, s. 369.
[22] WRA, s. 161.
[23] *Trust and Loan Companies Act*, S.C. 1991, c. 45, s. 374.
[24] For constitutional reasons it may not be possible for the provinces to remedy the latter situation.

Committee in its report on the former *Bankruptcy Act*.[25] One of those problems is the uncertainty created by the confusing state of the law governing the effect of statutory liens and deemed trusts in favour of the Crown. Generally speaking, uncertainty of this sort is inefficient. The Colter Committee also recognized that the priority position of the Crown seriously reduced the ability of an insolvent entity to achieve a successful restructuring.

Both efficiency and equity weigh in favour of amending the WRA to specify that Crown claims enjoy the same priority under the WRA as they do under the BIA. We see no justification for the blanket Crown priority currently found in the *Bank Act* and the TLCA. We also see no justification for the provisions of those statutes that give the federal Crown precedence over the provincial Crown. One aspect of the *Bank Act* regime that we do endorse however, is the subordination of fines and penalties. Both equitable considerations and the public interest in deterrence suggest that fines and penalties should be borne by shareholders - who, at least in theory, have the opportunity to control an institution's conduct - rather than creditors. Therefore, we recommend that the WRA include a priority scheme that treats all Crown claims save for those arising from fines or penalties in the same way that they are treated under the BIA. Claims arising from fines and penalties should be subordinated to all other claims.

In order to ensure that creditors of provincially incorporated trust and loan companies have the same priority relative to the Crown as creditors of banks and federally incorporated trust and loan companies we recommend that the *Bank Act* and the TLCA be amended to reflect this modified version of the BIA's approach to Crown priorities. This would be consistent with the federal government’s policy of having virtually identical legislation apply to federally incorporated financial institutions whenever possible.

[25] Proposed Bankruptcy Act Amendments: Report of the Advisory Committee on Bankruptcy and Insolvency (1986), pp. 76-79.

Preferred claims: general issues

The list of preferred claims recognized under the WRA is extremely short: it comprises only claims for the costs of administration[26] and a portion of the claims of employees.[27] By way of comparison, the BIA recognizes at least 7 classes of preferred claims (excluding the ones that are not likely to arise against an insolvent corporation).[28] The claimants omitted from the WRA's scheme but included in the BIA's scheme include municipalities, landlords, execution creditors and injured workers.[29] It seems reasonable to presume that the equitable considerations that inspired the BIA's scheme of preferred claims also apply in the context of proceedings under the WRA. This suggests that it would be appropriate to amend the WRA to create a set of preferred claims similar to those described in the BIA, subject however to the comments made below concerning the quantum of the preferred claims for arrears of wages and the priority of depositors' claims. We do not, however, recommend that the BIA's preferred claim for the fees and costs of the first execution creditor be included in the WRA. This preferred claim is anomalous and has little relevance under the WRA since an execution is unlikely to be filed against a financial institution before it is wound up. The other preferred claims referred to above should continue to rank behind any secured claims that the institution in question is permitted to create under its enabling legislation.

Claims for arrears of wages

As noted above the WRA already gives employees a preferred claim for any arrears of wages. In the interests of clarity it would be useful to modify the wording of this provision to conform to the wording found in section 136(1)(d) of the BIA. However, rather than limiting the amount of the preferred claim to a certain dollar value, we recommend that the quantum of the claim be limited to the amount due in respect of one regular pay period plus accrued vacation pay. This modification to the terms of the BIA provision is motivated in part by the view that it is particularly important to treat the

[26] WRA, s. 94.
[27] WRA, s. 72.
[28] BIA, s. 136.

employees of a troubled financial institution equitably because they typically play a critical role in determining the success (or failure) of the liquidation or restructuring process.

Depositors' claims: general issues

The claims of depositors presently enjoy the same priority as most other unsecured claims that are not defined as preferred claims. We recommend that the priority of depositors' claims be elevated in much the same way as the claims of policyholders of an insurance company. Specifically, depositors should have a preferred claim that ranks immediately below the claims for the costs of liquidation and arrears in wages. This claim should rank ahead of all secured claims other than those designated in the WRA or the enabling legislation of the institution in question. We also recommend that each depositor's preferred claim include amounts owed in respect of both principal and interest -otherwise inequities might arise between depositors who receive implicit and explicit interest payments. Interest would be calculated at the contractual rate until maturity of the instrument from which it arises. A market-indexed prescribed rate of interest would apply after the maturity of the instrument and to demand deposits.

This proposal has a number of attractive features. First, it would reduce the cost to CDIC of providing deposit insurance. Second, it would enhance the incentive of deposit-taking institutions' other unsecured creditors to monitor their debtors' financial status. Third, this proposal would ensure consistency between the treatment of depositors and policyholders. Finally, this proposal is consistent with the United States' 1993 decision to give domestic depositors' claims preference over all claims other than the receiver's administrative claims. Therefore, implementing this recommendation should not place Canadian institutions at a disadvantage relative to American federally-insured deposit-taking institutions.[30] On the other hand, we acknowledge that not all of the potential ramifications of enhancing the priority of depositors' claims are positive.[31] For example,

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[29] The BIA grants the Superintendent in Bankruptcy a preferred claim for the amount of the levy imposed under s. 147 of the BIA. There is no equivalent levy for firms being wound up under the WRA.
[30] 12 U.S.C. 1821(d) (11)(A).
[31] For critical analysis of a similar initiative in the American context see Bert Ely, "Comment: Surprise! Congress Just Enacted The Core Banking System," *American Banker*, September 21, 1993 at 24.

implementation of this recommendation may reduce the ratings of unsecured debt issued by Canadian deposit-taking institutions making it more costly for them to obtain financing from the capital markets

Depositors' claims against trust companies

The WRA is silent on the priority of depositors' claims against trust companies. The federal TLCA does address the matter but the effect of its provisions is somewhat unclear. On the one hand, that statute provides that a trust company is obliged to hold its depositors' funds on trust as "guaranteed trust money".[32] In this respect the statute implies that depositors' claims to the guaranteed trust money have priority over the claims of all of the trust company's other creditors.[33] On the other hand, section 374(1)(c) of the TLCA provides that the "the deposit liabilities of the company and all other liabilities of the company…shall be a third charge on the assets of the company", behind the first and second ranked claims of the federal and provincial Crowns. The "deposit liabilities of the company" are defined to mean money received as guaranteed trust money and the "assets of the company" are defined to include assets held by the company in respect of guaranteed trust money. Thus, not only does section 374(1)(c) clearly state that depositors' claims are subordinated to those of the Crown, it also implies that they rank equally with the claims of other unsecured creditors. This is inconsistent with the traditional understanding of the rights of a trust company's depositors.

The priority of depositors' claims against a provincially incorporated trust company is somewhat clearer. For example, under Ontario's *Loan and Trust Corporations Act* (the "LTCA")[34] a trust company is deemed to hold money received for investment purposes in trust.[35] However, unlike the TLCA, the LTCA does not contain any provisions dealing with the priority of claims against an insolvent trust company. In other words, in contrast to the TLCA, the LTCA does not suggest that depositors' claims against the guaranteed fund of a provincially incorporated trust company are

[32] TLCA ss. 2, 423.
[33] See generally, Thomas Cumming, "The Trust Claim of Depositors Against Insolvent Trust Companies" (1994), 10 Bank. &Fin. L. Rev. 151.
[34] R.S.O. 1990, L. 25.
[35] LTCA, s. 155(3).

subordinated to the claims of the Crown and other unsecured creditors. This leaves intact the presumption that as beneficiaries of a trust the depositors hold claims that take priority over the claims of the Crown and other unsecured creditors.

It would be useful for any law reform efforts in this area both to clarify the law and to eliminate any disparities in the treatment of federally and provincially incorporated trust or loan companies in insolvency. In order to be consistent with the preceding recommendation to elevate the priority of depositors' claims we recommend that the WRA and the TLCA be amended to provide that depositors' claims to the guaranteed trust money have priority over the claims of all of the trust company's other creditors. In addition, where the guaranteed trust money is insufficient to satisfy the claims of depositors their claim for the deficiency should rank as a preferred claim against the company's other assets, immediately behind the preferred claims for the costs of the liquidation and arrears of wages.

Claims on guarantees attached to segregated funds

In 1992 the priority of claims on guarantees provided to holders of interests in segregated funds was reduced without explanation: see WRA s. 161(2)(b). Claims on similar guarantees attached to insurance policies that do not involve segregated funds qualify for the priority generally afforded to policyholders' claims. We can see no principled justification for treating this particular class of policyholders' claims differently from other policyholders' claims. Therefore, we recommend that the distinction be abolished.

Recommendations:

- **Crown claims should be treated in the same way that they are currently treated under the BIA, save for claims arising from fines and penalties.**
- **Crown claims arising from fines and penalties should be subordinated to all other claims.**
- **The TLCA and the Bank Act should be amended to incorporate the same provisions as the WRA in respect of Crown claims.**

- **The WRA should recognize preferred claims in favour of municipalities, landlords and injured workers to the extent provided in the BIA.**
- **The preferred claim for arrears of wages should be modified to conform to the language found in section 136(1)(d) of the BIA except that the quantum of the claim should be limited to the amount due in respect of one regular pay period plus accrued vacation pay.**
- **The WRA, the TLCA and the Bank Act should be amended to provide that depositors in loan companies and banks receive a preferred claim that ranks immediately behind the preferred claims for the costs of the liquidation and arrears of wages and ahead of all secured claims except those designated in the statute.**
- **The WRA and the TLCA should provide that depositors' claims to the guaranteed trust money of a trust company have priority over the claims of all of the trust company's other creditors.**
- **The WRA and the TLCA should provide that where the guaranteed trust money of a trust company is insufficient to satisfy the claims of depositors their claim for the deficiency should rank as a preferred claim against the company's other assets in priority to all secured claims except those designated in the statute.**
- **The WRA, the TLCA and the Bank Act should provide that depositors' claims against the guaranteed fund of a trust company and their preferred claims against the assets of other financial institutions include claims for both principal and interest. Interest shall be calculated at the contract rate until the maturity of the relevant deposit and at a market-indexed prescribed rate after maturity and in the case of demand deposits.**
- **The claims referred to in section 161(2)(b) of the WRA should receive the same priority as other policyholders' claims.**

7. The Claims Process

Insolvency legislation requires rules that specify how creditors are to be identified, how the values of their claims are to be determined and how to treat claims that are identified after distributions have been made. In the case of financial institutions most claims are made by depositors or policyholders and are adequately reflected in the records of the institution. The claims process found in the WRA is able to deal with these sorts of claims efficiently as it does not contain mandatory provisions requiring all creditors to prove claims. This feature of the WRA should be retained.

There remain, however, significant concerns about the way in which the WRA deals with claims where proof is required. First, some of the rules currently found in the WRA are unsatisfactory because they tend to generate unnecessarily high administrative costs. Second, the WRA contains at least two separate and inconsistent sets of rules pertaining to these issues. The WRA has separate rules for insurance companies (sections 166 to 169) and other companies (sections 74 to 77, 85 and 87 to 92). Unfortunately though, the relationship between the two sets of rules is not specified and the Act has been interpreted to subject insurance companies to both sets of rules.[36] Furthermore, the rules in Part I of the Act are themselves inconsistent and subject claimants to two separate disallowance processes. Finally, several aspects of the insurance company rules are problematic, including the provisions concerning means of providing notice to claimants. In order to cure these deficiencies in the current statute we recommend that all of the existing provisions be repealed and that new provisions be drafted along the lines suggested below.

Identifying claims

Section 74 of the WRA provides that the court may direct the liquidator to call for the claims of creditors. However, as discussed, in the cases of policyholders and depositors it is typically less costly and more expeditious to have the liquidator identify claimants and set the value of their claims by relying upon the records of the financial institution. The exception would be where the liquidator believes that the institution's records are inadequate. Therefore we recommend that the present regime should continue in that the

[36] *Re Attorney-General of Canada and Northumberland General Insurance Co.* (1986), 56 O.R. (2d) 609.

liquidator should not be obligated to call for claims from policyholders and depositors and should be entitled to rely on the financial institution's records to identify their claims.

For creditors other than policyholders and depositors it seems appropriate to have the liquidator call for creditors to file proofs of claim within a prescribed period or reasonable period set by the liquidator. We recommend that a process similar to that found in sections 124 to 126 of the BIA be adopted. We note that the BIA requires creditors to use a prescribed form when proving their claims.[37] We recommend that an appropriate set of forms be created by regulation under the WRA. We do not recommend that the liquidator be required to prepare either a dividend sheet or a statement of claimants and creditors as contemplated by the current statute.

Valuing claims

In general we recommend that relatively detailed rules similar to those set out in section 135 of the BIA govern the process of valuing claims as opposed to leaving the process largely in the discretion of the court as provided in the current WRA. Therefore, in the case of claims proved by filing a proof of claim the amount set out in the proof of claim should govern unless the liquidator decides to require further evidence in support of the claim or to disallow the claim. In the case of contingent or unliquidated claims the liquidator should value the claim.[38]

Aside from these general remarks we also have recommendations about two other aspects of the valuation process. The first of these recommendations concerns the process for dealing with objections to the liquidator's initial valuation of a claim. A creditor should be entitled to appeal the liquidator's valuation to the court as provided in the BIA. The court presently has the authority to refer these disputes to alternative dispute resolution mechanisms, including a claims officer. This flexibility should be retained. In fact, we recommend that the court's power to refer disputed claims to alternative dispute resolution mechanisms be referred to explicitly in the Act.

The process outlined above departs from the current WRA in a number of respects but perhaps most notably by precluding third parties from objecting to a liquidator's

[37] BIA s. 124(2).

valuation of a claim. This departure is justified by the interest in minimizing costs and delay. In the interests of fairness creditors should be entitled to see and examine the proofs of other creditors as provided in section 126(1) of the BIA. However, creditors, shareholders, members and contributories should not be entitled to lodge formal objections to claims with the liquidator as contemplated in sections 87 to 92 of the current WRA.

Our final recommendation on this topic relates to valuation of claims in foreign currency. We recommend that a prescribed exchange rate be used to value these claims; we suggest the Bank of Canada noon spot rate on the date of filing.

Late claims

Under the current WRA the way in which late claims - claims proved after a partial distribution of the assets has been made - are to be treated is unclear. The Act simply states that these claims "shall rank with other claims of creditors in any future distribution of assets of the company." We recommend that this provision be amended to make it clear that any such creditor is not only entitled to receive a rateable share of any future distributions but is also entitled to receive a payment equal to its rateable share of previous distributions. Appropriate language can be found in section 150 of the BIA.

Recommendations:

- **The existing rules concerning the proof, valuation and allowance of claims should be repealed.**
- **The process by which creditors file proofs of claim should be codified in language similar to that found in sections 124 to 126 of the BIA.**
- **The liquidator should not be required to call for claims of policyholders and depositors and should be entitled to rely on the financial institution's records to identify the claims of those classes of creditors, as at present.**
- **The liquidator should value and allow claims according to rules similar to those found in section 135 of the BIA.**

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[38] The WRA currently requires the court to value these claims: s. 71(2).

- **A prescribed exchange rate should be used to value claims in foreign currency. That rate could be the Bank of Canada noon spot rate on the date of the filing of the petition for a winding-up order.**
- **In the case of policyholders and depositors, where dividends are being paid the liquidator should be required to notify claimants of the amount at which the liquidator values their claim. That amount will normally be the value from the financial institution's records less any applicable set-offs. If the claimant does not object within a prescribed time period the liquidator's valuation should govern.**
- **Creditors but not third parties should be entitled to appeal a liquidator's decisions concerning the valuation and allowance of their claims to the court.**
- **The court should be given explicit authority to refer disputes concerning the allowance of claims to alternative dispute resolution mechanisms, including a claims officer.**
- **A creditor whose claims are proved after a partial distribution has been made should be entitled to receive a payment equal to its rateable share of previous distributions in addition to a rateable share of any future distributions.**
- **A set of forms to be used in the claims process should be created by regulation.**

8. Administration

The roles of creditors, insurers and compensation providers

The WRA says very little about what role parties other than the Court and the liquidator are to play in the administration of a company being wound up. This administrative framework is unsatisfactory because it does not specify the role of the parties who actually have the greatest interest in seeing that the affairs of a company are wound up in an efficient and equitable fashion namely, the company’s creditors and their insurers or compensation providers. Providing a formal mechanism by which those parties can express their views to the liquidator may reduce the need for costly judicial intervention to resolve disputes.

One way to achieve this objective would be to permit creditors and any insurers or compensation providers to vote upon the appointment of inspectors who would then have the authority to provide directions to the liquidator. This is the approach taken under the BIA. However, this model is not suitable for proceedings involving a large number of creditors who individually hold relatively small claims. This is because collective action problems may prevent those creditors from participating effectively in the selection and instruction of inspectors. Such proceedings are common under the WRA because financial institutions' creditors often include numerous policyholders (in the case of an insurance company) or depositors (in the case of a deposit-taking institution).

Under the circumstances, a more appropriate solution seems to be to grant the Court the power to appoint a group of inspectors (we recommend a maximum of five), either on its own motion or upon an application by an interested party. Certain entities such as CompCorp and CDIC that provide insurance or compensation to a large number of creditors should have a statutory entitlement to be appointed an inspector. The liquidator should have an obligation to consult with the inspectors prior to making decisions on material matters unless satisfied that urgency will not permit this in a given case. The inspectors could also make recommendations to the Court on matters such as the approval of liquidators' fees and disbursements and whether to initiate attempts to restructure a corporation.

Appointment, powers and privileges of the liquidator

A number of relatively minor changes to the portions of the WRA dealing with the appointment, powers and privileges of the liquidator would serve to facilitate the administration of winding-up proceedings. First, current practice is to hold a meeting of the creditors of the company being wound up before appointing a liquidator (as opposed to a provisional liquidator). This practice seems to be grounded in the statutory requirement to provide notice to the creditors, contributories, shareholders and members of a company before appointing a liquidator.[39] There is no time limit for the giving of such notice. As a result in many cases no permanent liquidator is appointed and the estate is liquidated by the provisional liquidator. The notice requirement does not seem to serve any useful purpose and so we recommend that it be eliminated.

Second, in 1997 the BIA was amended to provide that a trustee in bankruptcy is not personally liable in respect of many claims against the debtor that arose before or upon the trustee's appointment.[40] The BIA also provides that the trustee is immune from liability for many environmental claims that arise after his or her appointment. Moreover, the estate can escape certain liabilities arising from environmental contamination if the trustee abandons or renounces any interest in the affected real property.[41] The WRA does not contain any similar provisions. Although financial institutions are less likely to face environmental liabilities than other corporations they do own premises and occasionally assume possession or control of real property in their capacity as lenders. Therefore, the same pragmatic considerations that justified the amendments to the BIA - the need to attract a person to assume control over an insolvent firm subject to environmental liabilities - support amending the WRA to include provisions similar to the ones found in the BIA.

A third point also arises from a comparison of the WRA to the BIA. The BIA contains a number of provisions that permit the trustee to obtain property of the bankrupt, and in particular books and records, held by third parties.[42] It is not clear whether the liquidator has equivalent powers. We recommend that the WRA be amended to provide that the liquidator has powers similar to those of a trustee in bankruptcy to obtain property and records of the insolvent institution being held by third parties.

Transnational proceedings

Parts II and III of the WRA make some provision for the winding-up of foreign banks and insurance companies with operations in Canada. However, Part I of the WRA, *i.e.* the Part containing the provisions of general application, does not include any

[39] WRA, s. 26.
[40] BIA, s. 14.06(1.2).
[41] BIA, s. 14.06(2)-(6).

provisions that specify the effects of either the initiation of foreign insolvency proceedings or the fact that a creditor has received a dividend in a foreign proceeding. Part I also does not indicate whether Canadian courts supervising winding-up proceedings are permitted either to render assistance to, or seek assistance from, foreign trustees, liquidators, receivers and administrators. It would be useful to add such provisions to the WRA in order to provide at least some guidance to courts supervising winding-up proceedings that involve Canadian firms with foreign operations. The relevant provisions could be modelled on those recently added to the BIA.[43]

Recommendations:

- **Inspectors may be appointed either at the instance of the Court or following an application by an interested party.**
- **The maximum number of inspectors should be five.**
- **Certain insurers and compensation providers should be entitled to be appointed an inspector.**
- **The liquidator should be obliged to consult with the inspectors in advance of material decisions unless satisfied that urgency will not permit this in a given case.**
- **The inspectors should have the power to make recommendations to the court.**
- **Section 26 of the WRA, which requires that notice be given to creditors, shareholders, members and contributories before the court may appoint a permanent liquidator, should be repealed.**
- **Provisions similar to those found in sections 14.06(1.2)-(6) of the BIA should be added to the WRA to limit the liability of the liquidator and the estate for environmental and other claims.**
- **The liquidator should have powers to obtain property and records of an insolvent institution being held by third parties that are similar to those of a trustee in bankruptcy.**

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[42] BIA, ss. 16(23)-17.
[43] S.C. 1997, c. 12, s. 118(1).

- **Provisions should be added to govern transnational proceedings.**

9. Restructuring

The restructuring - also known as reorganization – of a corporation involves modifying the terms of some or all of the financial claims against the corporation's assets. In cases involving business corporations restructurings are frequently initiated in order to preserve the difference between a corporation's going concern value and its liquidation value in circumstances where the corporation cannot be sold to a third party as a going concern. However, restructurings of financial institutions are relatively rare. One reason for this may be that because the assets of financial institutions tend to be relatively liquid the discrepancy between the going concern value and the liquidation value of a financial institution is relatively small. A second reason may be that the going concern value of many financial institutions, and particularly deposit-taking institutions, is likely to decline rapidly once financial distress sets in, implying that a rapid sale to a third party is the only way to preserve the institution's going concern value.[44]

Notwithstanding these considerations, there are cases in which it may be desirable to restructure a troubled financial institution. For example, it is not uncommon for the stakeholders in an insurance company to find it mutually advantageous to be able to restructure some, but not necessarily all, policyholders' claims simply because the company's liabilities exceed its assets or in order to facilitate the policies' administration by prospective reinsurers. It is also prudent to leave open the possibility of restructuring other types of financial institutions. However, in our deliberations we have focused on the potential for using the WRA to restructure a life insurance company and the following recommendations are only intended to apply to life insurance companies. From that perspective, the main deficiencies of the current statute are as follows.

First, the skeletal provisions concerning the initiation of restructuring proceedings do not acknowledge that there may be a public interest in either pursuing or avoiding a

[44] See generally, David Skeel Jr., The Law and Finance of Bank and Insurance Insolvency Regulation, (1998), Tex. L. Rev. 723 at 772-779.

restructuring and that public interest may not be reflected fully in the private interests of the company or its creditors. It is also unclear what sort of stay of proceedings against the company can be imposed if a restructuring as opposed to a winding-up has been initiated.

Second, the WRA seems to suggest that if any third party is appointed to monitor and/or govern the affairs of the company that party must be designated a "liquidator" and is obligated to cease carrying on the business of the company. However, where a restructuring is contemplated a "restructuring officer" as opposed to a "liquidator" should be appointed because the concept of a liquidation is somewhat inconsistent with the concept of a restructuring proceeding. Moreover, the appointment of a liquidator is likely to diminish public confidence in a firm.

Third, the WRA does not attempt to limit the duration of restructuring proceedings. This raises the prospect of protracted proceedings, a prospect that is troubling given the speed with which the going concern value of a financial institution is likely to decline.

Fourth, the WRA's restructuring provisions, which are modelled on those found in the CCAA, seem to contemplate class voting followed by court approval as the mechanism for settling the terms upon which a restructuring will take place. However, in the case of policyholders the costs of holding a class vote are likely to outweigh the benefits. A typical insurance company has a large number of policyholders and so it is likely to be extremely costly and time-consuming to hold a class vote. At the same time, it is not clear that a policyholder vote will provide much guidance to the court because, given the complexity of a typical insurance contract, assessing the fairness of a plan is likely to be beyond the expertise of most policyholders.

The recommendations that follow outline a regime that is intended to address these deficiencies. As discussed, this regime is only recommended for life insurance companies. However, we suggest that a similar regime be developed for property and casualty insurance companies and deposit-taking institutions.

Initiation of restructuring proceedings

The WRA either explicitly or implicitly provides that some form of restructuring plan may be proposed by any of a company in the course of being wound up, its creditors or the liquidator.[45] We recommend that this provision be modified to state explicitly that in the case of a life insurance company the authority to initiate a restructuring and file a restructuring plan extends to the company, the regulator having jurisdiction over the company, and the liquidator. It should also be provided that such an application can be made either before or after a winding-up order has been made in respect of the company. In order to ensure that the public interest is considered in determining whether to initiate proceedings the regulator should be entitled to notice of a company's intention to commence proceedings and should have the authority to bar proceedings. Notice should also be given to CompCorp as it may be the most significant creditor of the company in question and may wish either to object to the initiation of restructuring proceedings or to propose its own plan of restructuring.

The stay of proceedings

It is conventional for the initiation of formal restructuring proceedings in respect of a company to coincide with the imposition of a stay on proceedings against the company. The stay helps to preserve the value of the business during the course of the restructuring. The current WRA does not provide for such a stay to be imposed other than in connection with an application for a winding-up order. We recommend that provision be made for the court to impose a stay of proceedings upon application of the party seeking to initiate a restructuring. The court should be explicitly authorized to stay claims brought under reinsurance contracts, attempts to terminate reinsurance contracts, and attempts on the part of insurance brokers to transfer policies to other firms.

[45] WRA, s. 65.

Appointment and powers of the restructuring officer

The party initiating the restructuring proceeding should propose a restructuring officer. Other parties would be entitled to object to the proposed individual. In the event of disagreements as among the regulator, the company and CompCorp, the regulator should have the final choice of a restructuring officer. Once the restructuring officer has been selected the scope of his or her authority should be determined by the court. The court should also indicate whether and to what extent the restructuring officer is entitled to manage the company and continue to carry on its business.

Limiting the duration of restructuring proceedings

In order to avoid undue delay, once a restructuring has been initiated the restructuring officer should be obligated to produce a plan of restructuring within three months, or alternatively to report to the court on the prospects for a successful restructuring. The three-month period could be extended upon the approval of the court. During the three-month period the restructuring officer should provide interim reports to the court on his or her activities, including an opinion on the prospects of a successful restructuring.

Approval of restructuring plans

The WRA provides that a restructuring plan cannot be implemented unless it has been approved by both the creditors of the company being wound up - who vote by class - and the court. These mechanisms serve to ensure that parties whose legal rights might be abrogated under the plan are treated equitably. Similar rules are contained in the CCAA and Part III, Division 1 of the BIA. However, for the reasons outlined above a class vote may not be appropriate in the case of policyholders.

Section 162.2 of the current WRA goes some distance towards acknowledging these points by providing that the court has the authority to alter policies without holding a vote if the modifications will have "no adverse material impact on the policyholders under the terms of the policies". However, in certain cases it will be necessary to alter claims of policyholders in a way that *does* have an adverse material impact. Section 162.1

permits such alterations to be made but only seems to permit alterations that reduce the amount paid to policyholders by a certain percentage of the amount of their policies, with the same percentage applying to all policyholders. We recommend that the Act explicitly authorize the court to approve plans that alter claims of policyholders in an unlimited number of ways and even where doing so will have an adverse material impact on some policyholders. It should also be provided that this approval may be granted without holding a policyholder vote although if at all possible and practical policyholders whose claims are not covered by any sort of compensation fund should have a vote. In order to ensure that such alterations are fair and equitable to policyholders the court should not be allowed to permit alterations that will have an adverse material impact on policyholders if creditors or shareholders ranking below policyholders will receive value under the plan. Moreover, the court should be authorized to hear expert evidence on the impact of the plan and to appoint and hear submissions from representative counsel for various classes of affected policyholders.

For creditors other than policyholders, conditioning judicial approval upon approval by class vote appears to be the best method of preventing unfairness. One concern however, is that certain classes of creditors who would not receive any benefits if the corporation were liquidated might be able to delay restructuring proceedings by insisting on receiving benefits under the plan. Delay is always undesirable but can be particularly costly in the context of a troubled financial institution. Therefore, we recommend that the court be authorized to impose a plan on a dissenting class of creditors. In order to ensure that this power is exercised fairly the plan imposed must not provide benefits to any class of creditors of lower rank and must provide the dissenting class with benefits at least as great as those they would receive in a liquidation of the institution. This process is referred to as "cram down" in the United States and is permitted under Chapter 11 of the United States' Bankruptcy Code.[46]

Another concern about the voting rules presently contained in the WRA is that they deviate in two significant and arguably undesirable respects from the ones found in the BIA and the CCAA. First, under the WRA a plan will not be binding upon a class of creditors unless it is approved by creditors representing a majority in number and three-

[46] 11 U.S.C. § 1129(b)(2).

fourths in value of the class. By contrast, under the CCAA to bind the class a plan need only be approved by creditors representing a numerical majority and two-thirds in value of the class. As a consequence of this distinction it may be slightly more difficult to obtain approval of a plan under the WRA than under the CCAA or BIA. A second distinction between the WRA and other Canadian restructuring legislation is that it arguably permits the members of a class to be bound by a plan that has not been approved by creditors representing the majority (either in number or in value) of members of that class. The WRA permits a plan to become binding upon a class so long as it has been approved by creditors representing the requisite majority of the members of all classes considered together. This rule creates the possibility for significant unfairness. The most straightforward way to address both concerns is to amend the voting rules in the WRA to conform to those found in the CCAA.

Altering the rights of shareholders

Experience in the restructuring of non-financial firms has shown that in some cases it is useful to alter the rights attached to existing shares and issue additional shares without holding a shareholder vote as part of a restructuring. These techniques increase the range of capital structures that can be created for the restructured firm and enhance the ability of the creditors of the firm being restructured to obtain the benefit of accrued tax losses. Giving the court the ability to exercise these powers without holding a shareholder vote prevents shareholders from delaying the process in an attempt to extract benefits from other creditors. Consequently, we recommend that courts under the WRA be granted a broad power to alter the rights attached to shares of a company being restructured and to create new classes of shares without holding a shareholder vote. Appropriate language can be found in section 191 of the *Canada Business Corporations Act*.[47]

Recommendations:

[47] R.S.C. 1985, c. C-44 as am.

- **The Act should permit restructuring proceedings to be initiated in respect of a life insurance company whether or not a winding-up order has been made in respect of the company.**
- **The authority to initiate restructuring proceedings should extend to the company, the regulator having jurisdiction over the company and a liquidator. A company should not be able to initiate proceedings without giving a specified amount of notice to the regulator and CompCorp.**
- **Any party seeking to initiate a restructuring must obtain approval from the regulator prior to the commencement of the proceedings.**
- **The court should be authorized to impose a stay of proceedings against the company upon an application to initiate a restructuring.**
- **The stay should apply to claims brought under reinsurance contracts and should prevent termination of reinsurance contracts.**
- **The stay should apply to attempts on the part of insurance brokers to transfer policies to other firms.**
- **When a restructuring is contemplated a "restructuring officer" as opposed to a "liquidator" should be appointed.**
- **If there are any disagreements as among the regulator, the company and CompCorp, the regulator should have the final choice of a restructuring officer.**
- **The restructuring officer should be obligated to report to the court periodically on the prospects for a successful restructuring and to produce a plan of restructuring within three months or else obtain an extension from the court.**
- **The court should be authorized to approve plans that alter claims of policyholders in an unlimited number of ways and even where doing so will have an adverse material impact on some policyholders. It should also be provided that this approval may be granted without holding a policyholder vote although if at all possible and practical policyholders whose claims are not covered by any sort of compensation fund should have a vote. In order to ensure that such alterations are fair and equitable**

to policyholders the court should not be allowed to permit alterations that will have an adverse material impact on policyholders if creditors or shareholders ranking below policyholders will receive value under the plan. Moreover, the court should be authorized to hear expert evidence on the impact of the plan and to appoint and hear submissions from representative counsel for various classes of affected policyholders.

- **The court should be allowed to impose a plan on a dissenting class of creditors so long as that plan does not provide benefits to any class of creditors of lower rank and provides the dissenting class with benefits at least as great as those they would receive in a liquidation of the institution.**
- **The rules that govern voting on restructuring plans by creditors other than the policyholders of insurance companies should be amended to conform to the CCAA.**
- **The court should be granted a broad power to alter the rights attached to existing shares and to create and issue additional shares without holding a shareholder vote.**

10. Conclusion

There are a number of justifications for maintaining a distinctive regime to govern the liquidation and reorganization of financial institutions. However, the distinctive features of that regime tend to make it unsuitable for other types of firms. Consequently the first recommendation contained in this Report is that the WRA be amended to apply exclusively to the financial institutions that are explicitly excluded from the BIA.

Although the WRA may be more suitable than other statutes to govern the affairs financial institutions experiencing financial distress the Act as currently drafted is by no means satisfactory. As detailed above, the provisions of the WRA are both unclear and incomplete in a number of important respects. That is why the bulk of this Report has been devoted to outlining ways to both revise and expand the WRA.

For the most part the recommendations made above involve the adoption of rules that are already in use in the BIA, the CCAA or other statutes. The decision to opt for the familiar instead of the innovative has been made in a conscious effort to minimize the uncertainty that typically accompanies implementation of legal reforms. It is important to note however, that there are at least two areas in which innovation is required. First, one of the most serious deficiencies in the WRA is the complete absence of provisions that specify the role of creditors, insurers and compensation providers in the administration of a corporation being wound up. At the same time, the need to accommodate the interests of all those parties is the primary practical justification for establishing a separate regime to govern the liquidation of financial institutions. Consequently, of all the recommendations contained in this Report, those concerning the administration of corporations being wound up probably deserve the most immediate attention. The other innovative set of recommendations are those concerning the provisions of the WRA dealing with restructuring proceedings for life insurance companies. The distinctive features of financial institutions mandate the creation of a unique regime to govern their restructuring.

As the number of recommendations contained in this Report suggests, the WRA in its current form is an awkwardly worded and archaic piece of legislation. It could be improved considerably by being amended as proposed above. We are confident that if the recommendations outlined in this Report are adopted by Parliament the WRA will provide a much sounder framework for governing the affairs of troubled Canadian financial institutions than it does at present.

11.Summary of Recommendations

1. **The WRA should apply exclusively to financial institutions.**
2. **The list of financial institutions to which the WRA applies should include credit unions with total liabilities that exceed $100 million.**
3. **The BIA should be amended so that it does not apply to credit unions with total liabilities that exceed $100 million.**
4. **The BIA should be amended to provide that a trustee in bankruptcy may be appointed as a liquidator.**
5. **The Canada Corporations Act should be amended to provide for the liquidation and dissolution (while solvent) of all federal non-financial corporations currently subject to the WRA.**
6. **The WRA should bind the Crown and thus permit the stay and compromise of Crown claims in the course of winding-up and restructuring proceedings.**
7. **The avoidance powers in the WRA should be amended to conform to the corresponding provisions found in sections 91-101.2 of the BIA subject to the following exceptions:**
    - **The limitation period for non-arm's length preferences should be extended to 2 years.**
    - **The limitation period for reviewable transactions should be extended to 5 years.**
    - **For the purposes of the provisions dealing with reviewable transactions the definition of a related party should roughly correspond to the definition used in section 486 of the Bank Act.**
8. **Crown claims should be treated in the same way that they are currently treated under the BIA, save for claims arising from fines and penalties.**
9. **Crown claims arising from fines and penalties should be subordinated to all other claims.**

10. The TLCA and the Bank Act should be amended to incorporate the same provisions as the WRA in respect of Crown claims.

11. The WRA should recognise preferred claims in favour of municipalities, landlords and injured workers to the extent provided in the BIA.

12. The preferred claim for arrears of wages should be modified to conform to the language found in section 136(1)(d) of the BIA except that the quantum of the claim should be limited to the amount due in respect of one regular pay period plus accrued vacation pay.

13. The WRA, the TLCA and the Bank Act should be amended to provide that depositors in loan companies and banks receive a preferred claim that ranks immediately behind the preferred claims for the costs of the liquidation and arrears of wages and ahead of all secured claims except those designated in the statute.

14. The WRA and the TLCA should provide that depositors' claims to the guaranteed trust money of a trust company have priority over the claims of all of the trust company's other creditors.

15. The WRA and the TLCA should provide that where the guaranteed trust money of a trust company is insufficient to satisfy the claims of depositors their claim for the deficiency should rank as a preferred claim against the company's other assets in priority to all secured claims except those designated in the statute.

16. The WRA, the TLCA and the Bank Act should provide that depositors' claims against the guaranteed fund of a trust company and their preferred claims against the assets of other financial institutions include claims for both principal and interest. Interest shall be calculated at the contract rate until the maturity of the relevant deposit and at a market-indexed prescribed rate after maturity and in the case of demand deposits.

17. The claims referred to in section 161(2)(b) of the WRA should receive the same priority as other policyholders' claims.

18. The existing rules concerning the proof, valuation and allowance of claims should be repealed.

19. The process by which creditors file proofs of claim should be codified in language similar to that found in sections 124 to 126 of the BIA.

20. The liquidator should not be required to call for claims of policyholders and depositors and should be entitled to rely on the financial institution's records to identify the claims of those classes of creditors, as at present.

21. The liquidator should value and allow claims according to rules similar to those found in section 135 of the BIA.

22. A prescribed exchange rate should be used to value claims in foreign currency. That rate could be the Bank of Canada noon spot rate on the date of the filing of the petition for a winding-up order.

23. In the case of policyholders and depositors, where dividends are being paid the liquidator should be required to notify claimants of the amount at which the liquidator values their claim. That amount will normally be the value from the financial institution's records less any applicable set-offs. If the claimant does not object within a prescribed time period the liquidator's valuation should govern.

24. Creditors but not third parties should be entitled to appeal a liquidator's decisions concerning the valuation and allowance of their claims to the court.

25. The court should be given explicit authority to refer disputes concerning the allowance of claims to alternative dispute resolution mechanisms, including a claims officer.

26. A creditor whose claims are proved after a partial distribution has been made should be entitled to receive a payment equal to its rateable share of previous distributions in addition to a rateable share of any future distributions.

27. A set of forms to be used in the claims process should be created by regulation.

28. Inspectors may be appointed either at the instance of the Court or following an application by an interested party.

29. The maximum number of inspectors should be five.

30. Certain insurers and compensation providers should be entitled to be appointed an inspector.

31. The liquidator should be obliged to consult with the inspectors in advance of material decisions unless satisfied that urgency will not permit this in a given case.

32. The inspectors should have the power to make recommendations to the court.

33. Section 26 of the WRA, which requires that notice be given to creditors, shareholders, members and contributories before the court may appoint a permanent liquidator, should be repealed.

34. Provisions similar to those found in sections 14.06(1.2)-(6) of the BIA should be added to the WRA to limit the liability of the liquidator and the estate for environmental and other claims.

35. The liquidator should have powers to obtain property and records of an insolvent institution being held by third parties that are similar to those of a trustee in bankruptcy.

36. Provisions should be added to govern transnational proceedings.

37. The Act should permit restructuring proceedings to be initiated in respect of a life insurance company whether or not a winding-up order has been made in respect of the company.

38. The authority to initiate restructuring proceedings should extend to the company, the regulator having jurisdiction over the company and a liquidator. A company should not be able to initiate proceedings without giving a specified amount of notice to the regulator and CompCorp.

39. Any party seeking to initiate a restructuring must obtain approval from the regulator prior to the commencement of the proceedings.

40. The court should be authorized to impose a stay of proceedings against the company upon an application to initiate a restructuring.

41. The stay should apply to claims brought under reinsurance contracts and should prevent termination of reinsurance contracts.

42. The stay should apply to attempts on the part of insurance brokers to transfer policies to other firms.

43. When a restructuring is contemplated a "restructuring officer" as opposed to a "liquidator" should be appointed.

44. If there are any disagreements as among the regulator, the company and CompCorp, the regulator should have the final choice of a restructuring officer.

45. The restructuring officer should be obligated to report to the court periodically on the prospects for a successful restructuring and to produce a plan of restructuring within three months or else obtain an extension from the court.

46. The court should be authorized to approve plans that alter claims of policyholders in an unlimited number of ways and even where doing so will have an adverse material impact on some policyholders. It should also be provided that this approval may be granted without holding a policyholder vote although if at all possible and practical policyholders whose claims are not covered by any sort of compensation fund should have a vote. In order to ensure that such alterations are fair and equitable to policyholders the court should not be allowed to permit alterations that will have an adverse material impact on policyholders if creditors or shareholders ranking below policyholders will receive value under the plan. Moreover, the court should be authorized to hear expert evidence on the impact of the plan and to appoint and hear submissions from representative counsel for various classes of affected policyholders.

47. The court should be allowed to impose a plan on a dissenting class of creditors so long as that plan does not provide benefits to any class of creditors of lower rank and provides the dissenting class with benefits at least as great as those they would receive in a liquidation of the institution.

48. The rules that govern voting on restructuring plans by creditors other than the policyholders of insurance companies should be amended to conform to the CCAA.

49. The court should be granted a broad power to alter the rights attached to existing shares and to create and issue additional shares without holding a shareholder vote.

Principal Participants in the Insolvency Institute of Canada's

Review of the WRA

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