In late 2015, with an order of the Ontario Superior Court of Justice, the company suspended its special payments at the end of September 2015, while the restructuring process played out, and ceased providing post-retirement benefits, which included life insurance, medical and dental coverage. In the meantime, Morneau Shepell Ltd. took over administration of the pension plan.

A look at the guarantee funds

In March 2018, Sears Canada retirees got a measure of good news in the provincial budget, when Ontario’s governing Liberals announced that a government-run insurance program for plans with insolvent sponsors, would boost its monthly coverage limit by 30 per cent to $2,500 from $2,000. It also backdated the change to ensure Sears pensioners would be eligible for the extra money.

But on the other side of the ledger, “it was a cost of doing business,” says Eady. “But never in all the time that I spoke about that promise did it occur to me that it might not be kept. Maybe I’m naive, but that’s the case, then I’m not the only one.”

The Sears saga

Eady joined the company in happier times. By the early 1970s, Sears was thriving, with two decades of history already behind it in Canada. Its U.S. parent company had teamed up with a local retailer, Simpsons, to bring its department store and mail-order catalogue business north of the border in 1953.

Eady says he had few concerns when he retired. Despite a reported drop in same-store sales starting in 2005, the pension plan appeared insulated from the trouble. As recently as 2008, Sears Canada’s annual report disclosed a $241-million surplus in the main defined benefit plan. That was the year the company closed the plan to new members.

That surplus would be the last, with the global financial crisis gobbling it up and spurring out a $481.8-million deficit the following year. The figure piqued the interest of the retiree group, which stepped up its advocacy as the writing began to appear on the wall for Sears Canada in the subsequent years.

With the group having predicted the company’s demise in 2013, it began urging both Sears Canada and the Financial Services Commission of Ontario to wind up the pension plan before things got worse. In the meantime, it started writing to politicians of all stripes about the retirees’ concerns.

Despite those concerns, the company took advantage of Ontario’s solvency relief measures in 2016 to reduce the amount — to $13.9 million that year from $12.1 million, with further reductions in 2017 and 2018 — of the special payments it was making to cover the pension shortfall.

At a minimum, Morris says the British and U.S. examples should inspire every Canadian jurisdiction to cover at least the year’s maximum pensionable earnings, which for 2018 is $55,900 or $4,658 per month.

But Norma Nielson, a recently retired professor of insurance and risk management at the University of Calgary’s Haskayne school of business, warns against any clamour for guarantee funds.

By creating its pension guarantee fund in 1998, the Ontario government undertook a natural experiment in the area, she says. In a 2007 study, Nielson found that the existence of the fund was either the cause of, or showed high correlation with, lower solvency funding levels in that province in comparison to other Canadian jurisdictions.

“Sponsors were basically able to get away with investing less in the plan, which is what we describe as a moral hazard,” says Nielson.

She notes such funds often start with a flat-fee levy on defined benefit plans based on the size of their membership but says most, including Ontario’s guarantee fund, have switched to a risk-based assessment in the interest of fairness.

Malcolm Hamilton, a senior fellow at the C.D. Howe Institute, sees guarantee funds as a form of political cover for governments that want to avoid the appearance of a taxpayer bailout for failing private plans. “They can pretend it’s all self-sufficient and that public support...
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TOTAL PENSION ASSETS (MILLIONS) ARE REPORTED AS OF DEC. 31, 2017, UNLESS OTHERWISE INDICATED.

PA = Pension Assets

Indicates an increase or decrease in total pension assets from 2016.
isn’t inevitable,” says Hamilton.

But Hamilton says the charade is harder to keep up as the number of defined benefit plans dwindles and the premiums levied on those remaining surge.

“The bottom line is that there is no viable way for healthy pension funds to support unhealthy ones, so eventually some public subsidy is going to be required. If you look at the U.K. and the U.S. ones, they’re all basically insolvent,” says Hamilton, who spent most of his 40-year career as an actuary at Mercer. In 2017, Britain’s Pension Protection Fund reported a 310 per cent funding ratio, or a surplus of six billion pounds (£5.1 billion), for plans currently under its control for which it’s already paying benefits. While that looks promising, its PPF 780 index, which tracks the funding position of all of the roughly 5,000 plans that are potentially eligible for future entry, recorded a total deficit of £15.6 billion pounds (£400 billion) as of March 2018. The fund, then, could face a significant challenge if it started to see a significant number of new claims.

In the United States, the Pension Benefit Guaranty Corp. reported a US$46.7 billion deficit in its multi-employer plan and a US$40.9 billion shortfall in its single-employer insurance program at the end of the 2017 fiscal year. Hamilton says Ontario’s less generous version could allow the province to muddle through what he sees as the dying days of private sector defined benefit plans.

“If any luck, there won’t be too much money taxpayers have to throw at it,” he says. “There aren’t that many DB plans left, and they could get lucky if higher interest rates take the pressure off. In any case, it’ll be minor compared to government subsidization of public sector plans.”

**Disclosable events and other interventions**

In another apparent nod to Sears pensioners, Ontario’s budget also promised to develop a so-called disclosable events regime that would force plan sponsors to alert regulators to certain corporate developments. The note about the issue in the budget referred to events “such as significant asset stripping or the issuance of extraordinary dividends.”

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**PUTTING A RING ON IT**

Faced with a large pension deficit, U.S.-based Sears Holdings Corp. entered into an agreement with the Pension Benefit Guaranty Corp. in March 2016 to take a number of actions to shore up its plan. The agreement provided for a ring-fencing arrangement that meant the company couldn’t sell or encumber 140 Sears properties without the U.S. federal agency’s approval. In November 2017, the federal agency released the 140 properties from the ring-fencing arrangement. In exchange, Sears agreed to pay US$407 million into the pension fund from proceeds derived from selling or encumbering the properties. The 2017 agreement provided Sears with relief from contributions to the pension plans for two years, other than a US$20-million supplemental payment due in the second quarter of 2018.

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**Notes**

*2016 figures have been restated. 1. Pension assets reported as of March 31, 2017. 2. The New Brunswick teachers’ and public service shared-risk plans were unable to participate in the survey this year due to timing. Their totals are an estimate reflecting the average growth across the top 98 pension funds in 2017. 3. The telecoms sector includes Bell, BCE, Rogers, Telus and Telus Mobility. 4. Canadian Utilities Ltd. pension plan, ranked at No. 81 last year and ATCO Structures and Logistics were consolidated as ATCO Pension Funds. 5. Sources: Figures in the report are based on the top 100 plans participating in the 2018 Canadian Institutional Investment Network pension fund survey or annual reports. Benefits Canada assumes no responsibility for the accuracy of the data provided. All totals are subject to +/- variance due to rounding. If you would like to participate in future surveys, contact CII at sos@iimpc.tc or 418-847-5919.
Sears Canada retirees have hired a litigation investigator to explore the possibility of claims linked to almost $3 billion in dividends paid by the company to shareholders as it sold off many of its key Canadian assets between 2005 and 2013, which continued even as the pension plan slipped into the red. Sears Canada has insisted that all of its transactions were within the law.

Eady hopes the regime that emerges will mirror the one in the United States, which allowed the Pension Benefit Guaranty Corp. to negotiate a veto over the sale of certain properties held by Sears’ U.S. parent company in 2016. When the U.S. federal agency finally gave the green light to the sale of the assets, it did so in return for a US$400-million cash injection into the company’s underfunded U.S. pension plan.

“Earlier intervention is necessary and desirable,” says Eady.

Jeff Sommers, a partner in the pension and benefits practice group at Blake Cassels & Graydon LLP, says the government plan is light on details at this stage but notes his clients, which include both public and private plan sponsors and administrators, will be watching developments closely.

“I can see the logic, but imposing those kinds of obligations is not going to be well-received by many sponsors,” he says.

At the federal level, Prime Minister Justin Trudeau has remained noncommittal about legislative responses to the Sears Canada situation, but two members of Parliament are trying to force his hand with private member’s bills aimed at boosting the priority of pension plan members in bankruptcy proceedings.

The law as it stands classifies the unfunded portion of a pension plan as an unsecured debt, putting pension plan members behind secured creditors such as banks and bond holders. Bloc Québécois MP Marilène Gill wants to create a super priority for pensioners that places them at the front of the queue, while New Democratic Party MP Scott Duvall’s less radical proposal suggests putting them on par with secured creditors.

Ian Lee, an associate professor in the pension and benefits practice group at Carleton University, says either version risks reducing the availability of capital to companies with defined benefit pension plans and, therefore, hastening their decline in the private sector.

“As a former banker, I can tell you that banks are not in the business to give away money. If they thought their collateralized loans were not, in fact, going to be as secure because of a change in the Bankruptcy and Insolvency Act, then clearly, they will become more conservative in their lending,” he says.

“The knock-on consequences would be horrific.”

CARP doesn’t believe the repercussions of a priority change would be quite so dramatic. In Morris’ view, the current law doesn’t do enough to account for the needs of shortchanged pensioners.

“These people are vulnerable, and they’re not at an age where they can simply go back to work or cut back on their spending. They’ve planned around what they were promised,” she says.

“Banks and other investors are in a position to absorb more risk.”

In the meantime, Sears Canada retirees are placing their hopes in complicated arguments about whether the pension liability amounts to a deemed trust, which may elevate their priority in the CCAA proceedings.

**Questioning the DB guarantee**

Michael Armstrong, an associate professor at Brock University’s Goodman school of business, says the Sears Canada situation and the others that will inevitably follow should prompt a shift in the way employers sell defined benefit pension plans to employees. Workers also need to educate themselves about the realities of the pension promise, he suggests.

“Instead of fighting so hard as unions and employees for DB plans, we should realize they’re not really guaranteed,” he says.

That goes for public plans as well as private ones, he says, pointing to the City of Detroit’s decision to cut pensions as part of its bankruptcy proceeding. In fact, he has performed a risk assessment of his own pension at Brock. “It’s likely universities are going to be around for a long time. But on the other hand, if they ever did run into trouble, they can’t hike their prices or dig into profits. It’s not as insecure as if I worked for an auto manufacturer, but it’s also not as solid as if I worked for the federal government,” says Armstrong.

“DB plans are not risk-free, and that needs to be taken into account,” he adds.

Michael McKiernan is a freelance writer based in St. Catharines, Ont.