

The Lion's Share

Pension deficits and shareholder payments
among Canada's largest companies

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Executive Summary

Despite the decline in pension coverage among private sector employees, many of Canada's largest companies still maintain sizable defined benefit (DB) pension plans. Many of these plans are underfunded, which means that if they were rapidly wound-up because the corporate sponsor went bankrupt, beneficiaries would receive fewer benefits than they were promised. A current example of this is unfolding at Sears Canada Inc.

Underfunded pension plans are in part a result of the financial crisis and historically low interest rates. They are also the result of regulators extending the period to make up funding shortfalls. In many instances, companies are complying with the minimum payments but not making up their shortfall as fast as they could.

Thirty-nine of the companies on the S&P/TSX 60, representing Canada's biggest publicly traded companies, maintain a defined benefit pension plan. Those companies held \$174 billion in pension assets in 2016 amounting to a third of all private sector pension plan assets in Canada.

In 2016, the aggregate deficit of those plans was \$10.8 billion — up from a \$6.6 billion shortfall in 2015, but down substantially from the deficit of

\$20.3 billion in 2012. In every one of the past six years, the aggregated pension plans among Canada's biggest public companies were in deficit.

At the same time as pension deficits persist, shareholder payouts among those companies increased from \$31.9 billion in 2011 to \$46.9 billion in 2016. In other words, in 2016, Canada's largest companies paid out four times more to shareholders than it would have cost to fully fund their pension plans.

Individually, nine of the 39 plans were fully funded. Twenty five of the 39 plans (64%) could have been fully funded with less than a year's worth of payouts to shareholders. Another three plans could have been fully funded with less than two year's worth of payouts to shareholders. Only one plan, Bombardier Inc's, could not have been fully funded with less than two year's worth of shareholder payments. One company did not make any shareholder repayments.

Making up a pension shortfall is a periodic affair, but shareholder payments, particularly dividends, are often paid every year. Over a longer period, pension shortfalls can be made up with minimal impacts on shareholder payments. For the 18 companies with a shortfall of between 80% and 95%, the plans could be fully funded with just 13% of what was paid to shareholders over the past six years. Curiously, pension plans in seemingly worse shape with shortfalls of under 80% could be fully funded with only 6% of the shareholder payments since 2012. For almost all companies, DB plan shortfalls could be rapidly eliminated with little impact on shareholder payments.

Similar conclusions reached in the United Kingdom gave policymakers cause for concern, and resulted in proposals for new regulatory powers. Canadian governments should consider the following:

1. Limiting shareholder payouts when pension plans are underfunded: If companies demonstrate additional capacity to pay shareholders, Canadian regulators should consider that when determining payback periods for shortfalls. Alternatively, shareholder payouts can be made contingent on more rapid elimination of pension shortfalls.

2. Pension Benefits Guarantee Fund (PBGF) Premiums: In Ontario where DB plan benefits are insured up to a maximum of \$1,000 a month (soon to be \$1,500), premiums could be higher for companies not making up shortfalls. Otherwise, the government may be creating a "moral hazard" where companies pay shareholders with the knowledge that pension shortfalls will be made up by the province.

3. Mandatory Disclosure to the Regulator: At the very least, sponsors of severely underfunded pension plans should have to notify and obtain permission from regulators before making shareholder repayments.

Introduction

Workplace pension plans continue to play an important role in Canada's overall retirement security system. Traditionally, these took the form of defined benefit (DB) pension plans where sponsor firms guaranteed benefits after retirement. Over the past 30 years, the number of workers enrolled in DB plans has declined from nearly 50% of the workforce to one quarter.¹ The decline has been much more severe in the private sector where fewer than one in 10 workers has a DB plan. Today, most new plans are of the defined contribution (DC) variety. Under DC schemes, member payouts are the result of individual investment decisions and market performance. Despite growth of less generous DC schemes, more than four million Canadians continue to be members of DB pension plans, with over a million from the private sector.²

The claim that DB plans are unaffordable is widespread. Economic conditions over the past decade — characterized by ultra-low interest rates and slow economic growth — saw DB plans consume an increasing portion of firms' retained earnings. Plan sponsors cite these conditions when closing DB plans or converting them into DC schemes. While claiming their DB plans are unaffordable, however, Canadian firms have funnelled an enormous amount of cash to shareholders through dividends and share buybacks. In 2016 alone, S&P/TSX 60 firms with DB plans paid out a total of \$46.9 billion to shareholders. The S&P/TSX 60 includes the 60 largest companies by market capitalization on the Toronto Stock Exchange. The aggregate pension deficit among these same firms was \$10.8 billion.

The trend away from DB pensions towards DC schemes is part of a wider redirection of corporate earnings away from workers and towards shareholders. This process reflects a change in corporate thinking over the past several decades that seeks to better align executives' decision-making with shareholder interests, at the expense of other corporate constituencies like labour.³ As the quality and funding position of DB plans deteriorated, dividends and share buybacks soared.

Employers' claims of unaffordability arise not from a flaw in the DB plan structure, but from the narrow regulatory scope under which they are governed. If treated in isolation, pension funding will always be constrained

by how much sponsor firms are willing to direct towards labour. In order to effectively protect workers' retirement assets, pension regulation must expand to consider broader financial decisions within the firm.

Background

In recent years, large shareholder payouts coinciding with significant and persistent pension deficits have become increasingly common in the Anglo-American world. In the United States, firms have issued debt and used federal pension relief to fund share buybacks.⁴ Companies like General Electric spent a far greater amount on share buybacks in just a few years than the total shortfall in their pension plan.⁵ Research conducted in the United Kingdom in 2016 showed that the UK's largest public companies paid out £71 billion in shareholder dividends during the previous year, five times more than what they spent on pension contributions. Over a quarter of these companies could have eliminated their pension shortfalls altogether by diverting just half of the payouts they distributed to shareholders in a single year.⁶

These findings provoked the British government to observe that “there is no agreed definition of what level of pension contribution is affordable,” and that “employer contributions are rarely compared with other relevant figures such as profits or dividends.”⁷ Accordingly, the government has considered expanding the existing powers of the UK's pension supervisory authority, The Pension Regulator, to prevent corporate practices that could be materially detrimental to the funding position of DB plans. One of these was the requirement for formal consultation with plan trustees if a plan is severely underfunded and the sponsor is considering making dividend payments.⁸

The trend away from defined benefit pension plans

In countries where workplace pensions represent a significant portion of the overall retirement security system, the notion that DB plans are unaffordable is taken for granted. Employers have sought to insulate themselves from investment losses and mounting pension liabilities caused by low interest rates by shifting the burden of workers' retirement security to employees themselves.

DC plans and private savings vehicles like Registered Retirement Savings Plans (RRSPs) and Tax Free Savings Accounts (TFSA) are promoted as replacements for DB plans. Where the company once administered pensions

and guaranteed benefit levels, retirement income is now based on market performance and individual investment decisions. This transformation has had considerable repercussions on pensioners and their families. Rather than counting on a reliable cash flow in retirement, workers are expected to participate directly in equity markets and cope with business cycle fluctuations. Lacking the power of scale and scope enjoyed by large DB funds, individualized savings accounts are subject to substantially higher fees and greater volatility. Such retirement savings plans are notoriously vulnerable to “leakage,” as individuals raid their retirement savings accounts to cope with job loss, illness and injury, and other negative income shocks.⁹

In the United States, where the trend is further advanced than in Canada, studies found DC plans produce significantly lower retirement incomes overall when compared to their DB counterparts. DC plans have also been found to disproportionately benefit wealthy individuals.¹⁰ In the UK, the government recently implemented auto-enrolment into DC workplace pensions for most workers. However, UK studies show retirement accounts remain insufficient to prevent senior poverty in the future, with employers “levelling-down” pension contribution rates to the new statutory minimum.¹¹ Similar observations were made in Australia where DC plans have almost entirely supplanted DB plans, even in the public sector.¹²

The regulation of workplace pensions in Canada

Regulation of workplace pension funding in Canada began in the 1960s. As courts came to recognize plan members’ rights with respect to plan assets, provincial and federal governments enacted legislation that set up pension regulators.¹³ The regulators’ purpose was to ensure plans were funded adequately to fulfil promises made by employers to employees. Funding regulations initially relied on actuarial assessments that measured contributions and plan assets against long-term liabilities, ensuring that future retirement benefits were adequately funded. Alongside this *going concern valuation*, regulators began to apply additional *solvency* funding requirements meant to ensure a pension plan’s ability to pay out promised benefits in full if the plan was unexpectedly wound up.¹⁴ This new, more rigorous measure has formed the basis of DB pension plan funding formulas for the past several decades, although it is still weaker than full funding in some jurisdictions through a typical process of exceptions and exclusions to the application of the rule.

Even with solvency funding requirements in place, workers faced large benefit cuts if plan sponsors declared bankruptcy or entered creditor protection while the pension plan was in deficit. Rather than require an employer to eliminate a funding shortfall as soon as it was financial capable of doing so, solvency funding rules required an employer to make a schedule of special payments in order to gradually eliminate a funding shortfall over a specific period of time (five years in Ontario). This was intended to allow companies the flexibility and latitude to invest in business operations and product development in response to an economic shock or cyclical downturn that commonly accompanies the emergence of a pension plan deficit. Solvency rules required a minimum number and level of special payments to eventually eliminate a funding shortfall, and this schedule could be extended through temporary solvency funding relief that governments granted to employers.

While providing a floor under plan benefits, solvency funding rules purposely ignored what employers were doing with corporate earnings, as long as the required minimum required solvency payments were being met. In other words, broader corporate decisions about retained earnings are treated as a “black box” for the purposes of pension regulation. In certain instances, this could create a “moral hazard” in which firms had an incentive to direct cash flow to shareholders and directors, leaving as little as possible in a plan they could shed through eventual restructuring and insolvency.

In addition to the risks faced by plan members and retirees, pension funding deficits also represent a potential public cost. Benefits in Ontario are partially insured under the Pension Benefits Guarantee Fund (PBGF). DB plan sponsors are required to contribute to the PBGF, with premiums determined by a risk assessment process considering the plan’s size and its unique makeup of assets and liabilities. Each time the PBGF is required to cover obligations shed through bankruptcy or restructuring proceedings, the costs borne by the remaining sponsors increases. Taxpayers are also forced to pick up the slack when plan sponsors go under. In addition to ad-hoc financial support from governments, workers whose company pension benefits are slashed in insolvency court may have to rely on the Guaranteed Income Supplement (GIS) and provincial top-ups for low-income seniors in order to make ends meet. These programs are funded by governments through general taxation revenue.

Dividends and share buybacks

Shareholder payouts come in two forms. Dividends directly distribute profits to shareholders. They are usually paid on a regular basis with a fixed amount of profits allocated to investors based on the number and type of shares held. Special dividends are also paid on occasions when large influxes of cash cannot be efficiently reinvested in the firm or when a large, active shareholder demands short-term returns.

Share buybacks see publicly traded firms repurchase shares on the stock market for cancellation. This reduces the number of outstanding shares, increasing the value of those still on the market. The practice has increased dramatically in recent decades as financial regulators distinguished between permissible buyback programs and insider trading. Most share buyback programs in Canada are conducted through Normal-Course Issuer Bids (NCIBs) which permit a firm to repurchase up to 10% of its outstanding shares.

Regulatory intervention to limit shareholder payouts

In principle, shareholders are recipients of the residual profit of an enterprise. They are explicitly at risk, and their returns are supposed to be a function of this risk-taking. On the other hand, pension plan funding is a cost of doing business. Pension funding is an obligation to be satisfied before shareholders receive their returns. This order is inverted when sponsors of underfunded pension plans make payments to shareholders through buybacks and dividends. But the proposition that shareholders should not be paid until the obligations of the business are satisfied should not be controversial.

Expanding pension regulation to encompass sponsor firms' shareholder payout practices is not without precedent. Targeted, ad-hoc intervention has occurred in Canada. Facing capitalization concerns – both in relation to pension health and more broadly – regulators have taken action to limit shareholder payouts. Expanding the scope of pension regulation to include dividends and share repurchases is a natural response to the growth of these practices.

Large financial institutions were among the most exposed to mortgage-backed securities and other assets that precipitated the Global Financial Crisis. Canada's chartered banks were no exception. Recognizing the need to stabilize financial markets, the Office of the Superintendent of Financial Institutions (OSFI), issued a notice in 2008 insisting that banks and insur-

ance companies halt any planned buybacks and consult OFSI before proceeding.¹⁵ It would be another four years before any of the major banks initiated a share repurchase program.

Canadian chartered banks weathered the crisis relatively well by focusing on repairing their balance sheets instead of paying shareholders. While it is possible the banks would have refrained from buybacks on their own, OSFI's intervention recognized the perverse incentives faced by corporate decisionmakers and the danger value extraction posed to the wider economy.

The federal government also intervened to limit shareholder payouts when Air Canada's large pension shortfall threatened the carrier's solvency. This episode stands as the strongest instance in the North American context of a regulator recognizing the relationship between excessive shareholder payouts and pension neglect. Facing a \$4.2 billion funding shortfall in 2013, Air Canada was given pension funding relief from the federal government so long as executive pay hikes were capped at inflation and shareholder payouts stopped until pensions were made whole. Air Canada agreed to the terms of temporary solvency funding relief, and eventually opted out of the arrangement in 2015 with a pension surplus of over \$1 billion.¹⁶

Comparing the Air Canada deal to the general funding relief offered to all companies by the Ontario government in 2009, 2012, and extended in 2016, which included no capital management restrictions, the need for a more expansive regulatory scope is apparent. With the general relief program in effect, shareholder disbursements peaked while firms enjoyed an extension of the period of time in which they had to restore solvency.¹⁷

Policies that ease special payment obligations while doing nothing to temper the stream of value funnelled out of firms exacerbate the problems they purport to solve. A general policy limiting shareholder payouts during funding shortfalls could be within the scope of regulatory power and would remain consistent with the aims of relevant legislation. The regulatory response could also mandate an accelerated funding formula accompany payouts.

The cautionary tale of Sears Canada Inc.

Canadian subsidiaries being raided by American parents is an all-too-familiar story with Canadian pensioners (not to mention suppliers and the courts) left to pick up the pieces in bankruptcy. Sears Canada should serve as a cautionary tale to Canadian pension regulators in particular.

The recent news that Sears Canada will shutter all remaining stores as a result of its insolvency¹⁸ leaves its DB pension plan with a \$267 million funding shortfall on a wind-up basis.¹⁹ Since 2010, Sears Canada paid back \$1.5 billion to shareholders in dividends and share buybacks.²⁰ In other words, Sears Canada paid back five-and-a-half times more to its shareholders than it would have cost to entirely erase the deficit in its DB pension plan. As Sears proceeds to liquidate its entire Canadian operations, it will be Canadian retirees who are left to deal with that decision.²¹ Regulators, policy-makers, and Canadians will quite rightly ask whether this disaster could have been avoided.

The Results

The audited year end financial statements were collected from the System for Electronic Document Analysis and Retrieval (SEDAR) for all companies on the S&P/TSX 60 over the past five years. All companies that maintained non-executive DB plans, 39 of the 60, are included in the study. Where possible, the executive DB plans are separated and not included. While on the books of Canadian companies, these pension plans may be payable to non-Canadian beneficiaries either in part or in full. The nationality of pension beneficiaries in most cases is not broken out in annual filings. In many cases, the plans are no longer available to new employees.

This study reviews roughly a third of all private sector pension assets totaling \$174 billion of the \$537 billion in private sector pension assets in Canada in 2016. The \$174 billion figure for the 39 S&P/TSX 60 companies that have pension plans may include assets for non-Canadian pension plans and, as such, these figures should be seen as approximations. Nonetheless, the companies included in the study represent a notable proportion of all private sector plan assets in Canada.

The largest five S&P/TSX 60 companies outlined in *Table 2*, with \$74 billion in plan assets, represent 43% of the S&P/TSX 60 total plan assets.

In 2016, the aggregate position for S&P/TSX 60 companies with a pension plan was a pension deficit of \$10.8 billion, including the surplus positions of several of the large plans. This understates the costs of a pension plan wind-up upon insolvency, for example, which could be substantially more.²² While this deficit position has grown from \$6.6 billion in 2015, it remains smaller than deficits found in 2011 and 2012.

TABLE 1 S&P/TSX pension plans proportion of all private sector pension plans (2016)

	Pension plan assets (\$mil)
Total S&P/TSX 60 companies	\$174,011
Total private sector registered pension plans in Canada	\$537,390
Study coverage rate	32%

Source Cansim 280-0018, 2016 S&P/TSX company filings, \$USD reporting converted to \$CDN at the average 2016 exchange rate of 1.3256 using Cansim 176-0064. S&P/TSX company pension plan asset values may include benefits due to non-Canadian beneficiaries.

TABLE 2 Largest S&P/TSX 60 pension plans (2016)

Company name	Symbol	Fair market value of plan assets (\$CDN mil)
BCE Inc. (Bell Canada Enterprises)	BCE	\$20,563
Canadian National Railway Company	CNR	\$17,831
Royal Bank of Canada	RY	\$12,459
Canadian Pacific Railway Ltd.	CP	\$12,196
Bombardier Inc.	BBD.B	\$10,968

Source 2016 S&P/TSX company filings, \$USD reporting converted to \$CDN at the average 2016 exchange rate of 1.3256 using Cansim 176-0064.

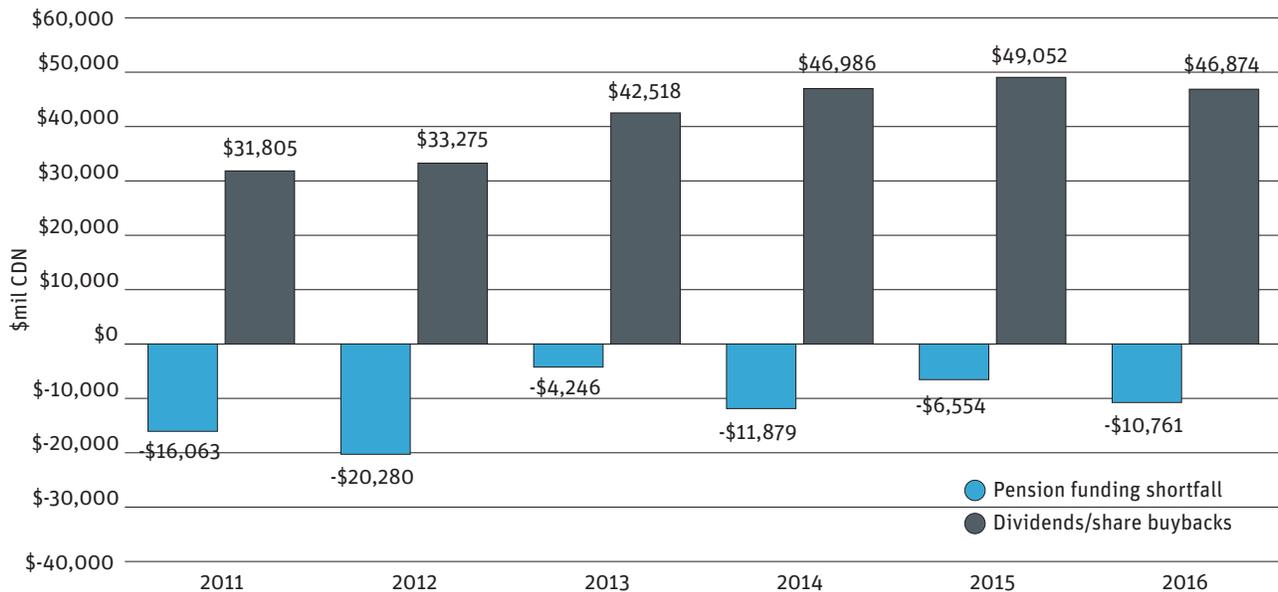
TABLE 3 S&P/TSX 60 companies with pension plans by shortfall (2016)

	Count	Proportion of 39 company plans
Pension plans fully funded ($\geq 95\%$)	12	31%
Pension plans almost fully funded (80% to 95%)	16	41%
Pension plans far from fully funded ($< 80\%$)	11	28%
Total	39	100%

Source 2016 S&P/TSX 60 company filings with pension plans

At the same time, payments to shareholders via dividends or share buy-backs have increased since 2012 and remained at a higher level over the past four years of at least \$43 billion a year. In each of the past six years, payments to shareholders substantially exceeded the pension deficit; in 2016 alone, payments to shareholders were four times the value of the pension deficit for those companies with pension plans. Similar results in the United Kingdom gave policymakers cause for concern resulting in proposals for new regulatory powers.²³

FIGURE 1 Pension shortfalls vs shareholder payments



Source 2016 S&P/TSX company filings, includes only companies with a pension plan, \$USD reporting converted to \$CDN using yearly exchange rate from Cansim 176-0064. The aggregate "Pension funding shortfall" includes pensions that are in surplus.

Table 3 breaks down the pension plans of Canada's largest publicly traded companies. Twelve of the 39 companies — about a third — have defined benefit pension plans that are essentially fully funded, with at most a minor shortfall that may be due to short term market fluctuations. Nine of those companies are in surplus. Sixteen of the 39 companies (41%) have a larger shortfall that sits between 80% and 95% of actuarial liabilities. The final third of companies have a more concerning shortfall, with actuarial assets making up less than 80% of actuarial liabilities.

Despite a relatively even spacing of the company plans across the three categories in *Table 3*, there is little doubt that, if companies wished, in almost all cases they could rapidly return their pension plans to a fully funded position. Of the 39 companies with pension plans, nine are already fully funded, and one company, Eldorado Gold Corp. provided no shareholder payments in 2016.

Twenty-five companies could make up their pension shortfall with under a year's worth of shareholder repayments through dividends and share buybacks. Even shortfalls for companies whose pension plans have larger shortfalls and are less than 80% funded could be easily made up with less than one year's worth of payments to shareholders.

TABLE 4 Time to repay pension plan shortfall from shareholder payments (2016)

Time to repay	100% to 80% funded	<80% funded	Total
Fully funded	9		9
Repay with at most 1 year of shareholder payouts	16	9	25
Repay with between 1 to 2 years of shareholder payouts	3	0	3
Repay with more than 2 years of shareholder payouts	0	1	1
No shareholder payments	0	1	1
Total	28	11	39

Source 2016 S&P/TSX 60 company filings for companies with pension plans

TABLE 5 Top five companies by pension funding shortfalls \$CDN mil (2016)

Company	Plan assets	Funding shortfall	Funding ratio	Shareholder payments	Years to repay shortfall from shareholder payments
Bombardier Inc	\$10,968	-\$2,963	73%	\$23	131.5
Bank of Nova Scotia	\$7,770	-\$1,369	82%	\$3,678	0.4
Power Corporation	\$7,104	-\$1,320	81%	\$664	2.0
Imperial Oil Ltd.	\$7,359	-\$997	86%	\$492	2.0
Toronto-Dominion Bank	\$5,823	-\$982	83%	\$4,295	0.2

Source 2016 S&P/TSX company filings, \$USD reporting converted to \$CDN at the average 2016 exchange rate of 1.3256 using Cansim 176-0064.

Except for one company pension plan, all the others could be fully funded with less than two years worth of payments to shareholders. In other words, the financial capacity clearly exists among S&P/TSX 60 companies to clear pension deficits and fully fund company pensions. However, corporate decisions have directed additional financial capacity towards shareholders, and not towards pension obligations of current and former employees.

Table 5 breaks out the five companies with the largest pension funding deficits ranked by the dollar value of the deficit, the largest shortfall being Bombardier's at just under \$3.0 billion. At present, Bombardier pays a very small dividend related to preferred shares, and has lost money in both 2016 and 2015. Clearly, given Bombardier's financial position, neither investors nor the pension plan are being paid back in a meaningful way. It would take 131 years to pay back the pension deficit using shareholder repayments.

Four companies' pension plans would have little or no difficulty paying off their pension deficit in, at most, two years. The Bank of Nova Scotia, with

TABLE 6 Average reduction in combined shareholder payouts 2016–2012 to fully fund pension plans

Pension funding ratio	99% to 95%	95% to 80%	<80%
Company count	3	18	9
% reduction in shareholder payments	3%	13%	6%

Source 2016 S&P/TSX 60 company filings with pension plans, excludes Bombardier Inc. which otherwise heavily skews the average for the <80% funded pension fund category.

the second largest pension deficit of \$1.4 billion in 2016, transferred \$3.7 billion to shareholders through share repurchases and dividends payments. In other words, payments to shareholders were worth more than two and a half times what it would take to cover the pension shortfall for workers in 2016.

While *Table 5* focuses on companies with the largest pension deficits, the same situation repeats itself among most S&P/TSX 60 companies with pension plans; they have the capacity to almost immediately make up their pension deficits, yet choose to pay those amounts to shareholders instead.

Pension deficits need only be made up once; they are generally a periodic or cyclical affair, barring a negative shock to asset returns. In contrast, dividend payments are more regular, often recurring year after year, except in the case of extraordinary dividends. Stock repurchases are more infrequent, and are often the result of one-time transfers to shareholders.

In the context of different time frames, it's worthwhile comparing how much less investors would have made over the past five years had their company chosen to make up the 2016 pension shortfall out of shareholder payments. Irrespective of the funding shortfall as a proportion of total liabilities, the impact on what investors would have received — had benefits been fully funded — is minimal.

It might be expected that pension funds closer to being fully-funded would experience the smallest impact if those funds were fully-funded out of shareholder payouts; *Table 6* bears that out. However, what is perhaps unexpected is that, even for pension funds that are 80% funded or less, the impact of making them fully-funded would only have reduced shareholder payouts by 6%. *Table 6* excludes Bombardier Inc, which heavily skews the average figure; nonetheless, the impact on payments to shareholders of fully funding their company's DB plan would be minimal.

This isn't to say that adequately funding pension plans *must* be paid for by reducing shareholder payments. It could also be accomplished by selling equity or incurring debt. However, what is clear is that almost all of the

large companies examined have the capacity to make up pension deficits much more rapidly than they presently are.

Conclusion and Recommendations

To properly assess the level of risk expressed in the funding level of a DB plan, pension regulators need to assess the default risk of the plan sponsor. That sponsors might increase their risk exposure in the knowledge that pension liabilities can eventually be shed further obliges pension supervisory authorities to integrate the firm's credit risk and capital allocation practices into their assessment. Expanding the scope of pension regulation to include share repurchases and dividends would be consistent with the regulator's purpose: ensuring the security of retirees' benefits.

1. Limit shareholder payouts when pension plans are underfunded

The most appropriate and effective way to limit firms' ability to direct cash flow to shareholders when pension benefits are underfunded would be a generally applied policy that could take one of several forms. Payouts could either be made contingent on a certain level of pension solvency, or the regulator could be permitted to shorten amortization periods for paying down funding shortfalls when shareholder payouts are deemed excessive. The former approach would see sponsor firms whose pension funding falls below a certain threshold — for example 85% — prohibited from increasing dividends or engaging in buybacks. The latter would increase legally mandated contribution rates to pension plans when firms engage in excessive payouts. These contribution rates could either increase on a scale, or kick-in at a predefined level. The key is to ensure the policy is equally applied and does not impose an unreasonable burden on plan sponsors while still protecting benefit recipients. The goal is not to require that plans be fully-funded at all times regardless of circumstance, but rather to prevent shareholder payouts from jeopardizing members' benefit security by making the former contingent on the latter.

In 2015, the province of Quebec eliminated solvency funding for private-sector DB plans, and replaced it with a stabilization provision (or reserve) funded on a going-concern basis. The size of the stabilization provision is determined by the risk profile of the pension fund's investments, with a larger funding cushion required for plans that allocate a greater proportion of

assets to equities and other higher-risk asset classes, and a smaller cushion for funds with a higher proportion of bonds. Ontario's creation of a new funding framework for DB plans will also replace existing solvency rules with enhanced going-concern funding, along with the requirement to fund a reserve similar to Quebec's stabilization provision (termed a Provision for Adverse Deviation, or PfAD). Ontario has yet to announce the criteria for establishing the size of the PfAD, but could include share buybacks and dividends in its assessment of the risk level of a pension fund's investment policy, for the purposes of determining the size of the PfAD. The Ontario government's proposal to lower the solvency funding target to 85% will almost certainly reduce the level of funding to underfunded DB plans, diminishing members' benefit security, and increasing the level of risk shouldered by the PBGF. Restrictions on dividends and share buybacks are therefore modest offsets to the increased risks borne by plan members (and PBGF funders) as a result of funding rule changes.

In the United Kingdom, the Pensions Regulator's (TPR) "moral hazard" powers contained in the 2004 Pensions Act go some distance towards considering shareholder payouts in the context of pension regulation. These include the ability to issue liabilities against plan sponsors or associated entities in the form of contribution notices (CNs) when plans are wound up. Also described as TPR's "anti-avoidance powers," these abilities contribute to a more powerful regulatory posture compared to the North American context and will likely expand in the future.²⁴ Legislation in Canada only permits regulators to evaluate whether or not actuarial payment schedules are appropriate and in compliance with funding regulations. In contrast, TPR may dictate funding schedules directly in the interest of plan members. A move away from the current reactive posture towards a more active regulatory standing in Canada would be a good first step in strengthening workplace pension security, bringing capital allocation decisions within the scope of pension regulation.

2. PBGF Premiums

For Ontario plans insured by the PBGF, the risk assessment process used to determine individual sponsor premiums should be expanded to consider shareholder payouts. Sponsors with large funding shortfalls who engage in excessive payouts should be treated with scrutiny. Currently, the PBGF levies annual premiums that reflect a per-member fee, as well as a risk-related fee imposed on underfunded plans, according to a sliding scale based on

the level of underfunding. The Ontario government could include in the PBGF's risk-based assessment the degree to which plan sponsors are engaging in share buybacks and dividend payments to shareholders.

The Pension Benefit Guaranty Corporation (PBGC) in the United States already uses the payment of “extraordinary dividends” as a criterion when it decides to intervene and stabilize distressed plans by negotiating with sponsors.²⁵ Adopting a similar outlook in Ontario would both strengthen the PBGF as it increases its guarantee from \$1,000 to \$1,500 per month, and mitigate taxpayers' exposure to increased risk. Similarly, the Government of Ontario has indicated it is reviewing the process governing pension plan wind-ups, and examining the creation of a public agency tasked with administering benefits for wound-up plans. Insofar as this step would also increase the Ontario government's exposure to additional moral hazard risk, the government should develop mechanisms to dissuade DB sponsors from rewarding shareholders while pension plans remain underfunded.

3. Mandatory Disclosure to the Regulator

At a minimum, sponsors who increase dividends or initiate share buyback programs when their plans are significantly underfunded should be required to notify, consult with and, ideally, seek approval from plan members and the regulator. The American Pension Benefit Guaranty Corporation already identifies “extraordinary dividends” as a reportable event, requiring plan sponsors to disclose such events.²⁶ The PBGC also explicitly includes “the payment of a very large dividend to shareholders” as an event that may pose an increased risk to plans and, therefore, to the PBGC.²⁷

A disclosure requirement would strengthen workers' retirement security in several ways. The regulator would better understand the extent of the problem. Information about pension health and shareholder payouts among private equity firms is lacking, but important. It is probable that the practice of underfunding and excessive payouts is more advanced among firms operating without the same scrutiny their publicly traded counterparts face. Mandatory disclosure and consultation would also help pension members and their representatives protect their benefits and plan for the future.

Appendix

DATA USED IN this report were compiled from audited annual financial statements of the S&P/TSX 60 companies that reported having a defined benefit pension plan in 2016. Those reports were downloaded from the www.SEDAR.com website in August 2017. Dividends include both preferred and common dividends and are recorded in the consolidated statement of cash flow. Share repurchases are recorded from the consolidated statement cash flow as well. Pension plan deficits are reported on a financial accounting basis, which is similar to a solvency basis but not identical. The cost of a plan wind-up, for instance in insolvency, would likely be much higher than either the financial accounting or the solvency basis. The figures below, as well as at every point in this report, are nominal dollars in the currency of reporting, unless aggregated. If aggregated, US dollar reporting is converted to Canadian dollars at a rate of 1.3256, 1.2788, 1.1047, 1.0301, 0.09993 and 0.9893 for the years 2016, 2015, 2014, 2013, 2012 and 2011 respectively as per their average annual values from Statistics Canada CANSIM 176-0064. Years reported correspond to the years from the audited financials.

TABLE 7 S&P/TSX 60 pension plans and shareholder payouts, 2015 and 2016

Company name	2016				2015			
	DB plan assets	DB funding balance	Share repurchases	Dividend payments	DB plan assets	DB funding balance	Share repurchases	Dividend payments
Agrium Inc. (USD)	\$266	-\$65	\$0	\$482	\$253	-\$57	\$559	\$468
Alimentation Couche-Tard Inc. (USD)	\$165	-\$59	\$0	\$104	\$304	-\$109	\$0	\$87
Bank of Montreal	\$8,655	-\$337	\$0	\$2,219	\$8,072	\$138	\$618	\$2,135
Bank of Nova Scotia	\$7,770	-\$1,369	\$80	\$3,598	\$7,615	-\$498	\$955	\$3,406
Barrick Gold Corporation (USD)	\$191	-\$66	\$0	\$86	\$201	-\$80	\$0	\$160
BCE Inc.	\$20,563	-\$290	\$0	\$2,305	\$20,244	-\$431	\$0	\$2,169
Bombardier Inc. (USD)	\$8,274	-\$2,235	\$0	\$17	\$8,080	-\$1,642	\$0	\$19
Brookfield Asset Management Inc. (USD)	\$592	-\$198	\$148	\$633	\$576	-\$160	\$424	\$584
Canadian Imperial Bank of Commerce	\$7,458	\$40	\$270	\$1,917	\$6,997	\$463	\$11	\$1,753
Canadian National Railway Company	\$17,831	\$465	\$1,992	\$1,159	\$17,917	\$836	\$1,742	\$996
Canadian Pacific Railway Ltd.	\$12,196	\$797	\$1,210	\$255	\$12,300	\$1,106	\$2,787	\$226
Cenovus Energy Inc.	\$125	-\$48	\$0	\$166	\$128	-\$40	\$0	\$528
Eldorado Gold Corp. (USD)	\$2	-\$11	\$0	\$0	\$2	-\$7	\$0	\$11
Emera	\$2,208	-\$399	\$0	\$249	\$1,300	-\$220	\$0	\$192
Enbridge Inc.	\$2,380	-\$398	\$0	\$1,443	\$2,229	-\$322	\$0	\$1,238
Encana (USD)	\$194	-\$17	\$0	\$51	\$208	-\$4	\$0	\$152
Fortis Inc.	\$2,646	-\$391	\$0	\$388	\$2,466	-\$362	\$0	\$309
George Weston Ltd.	\$2,099	\$22	\$8	\$265	\$2,485	\$20	\$14	\$198
Husky Energy Inc.	\$183	\$5	\$0	\$27	\$181	\$4	\$0	\$1,203
Imperial Oil Ltd.	\$7,359	-\$997	\$0	\$492	\$7,260	-\$887	\$0	\$449
Loblaw Company Ltd.	\$1,947	\$43	\$708	\$425	\$2,167	\$43	\$280	\$416
Magna International Inc. (USD)	\$330	-\$294	\$913	\$385	\$326	-\$167	\$515	\$354
Manulife Financial Corporation	\$4,277	-\$490	\$0	\$1,593	\$4,122	-\$701	\$0	\$1,427
Metro Inc.	\$1,124	-\$105	\$0	\$127	\$1,002	-\$34	\$0	\$112
National Bank of Canada	\$3,776	-\$67	\$176	\$600	\$3,521	\$258	\$200	\$717
Pembina Pipeline Corporation	\$164	-\$16	\$0	\$351	\$146	-\$14	\$0	\$294
Potash Corporation of Saskatchewan Inc. (USD)	\$1,246	-\$84	\$0	\$809	\$1,197	-\$108	\$0	\$1,204
Power Corporation	\$7,104	-\$1,320	\$2	\$662	\$6,963	-\$1,075	\$2	\$618
Rogers Communications Inc.	\$1,619	-\$387	\$0	\$988	\$1,432	-\$281	\$0	\$977
Royal Bank of Canada	\$12,459	-\$1,420	\$362	\$4,997	\$11,896	-\$78	\$0	\$4,564
SNC-Lavalin Group	\$225	-\$97	\$0	\$156	\$238	-\$80	\$122	\$151
Saputo Inc.	\$57	-\$31	\$92	\$210	\$64	-\$36	\$49	\$198
Sun Life Financial Inc.	\$3,243	-\$302	\$0	\$1,074	\$3,193	-\$247	\$212	\$921
Suncor Energy Inc.	\$5,356	-\$924	\$0	\$1,877	\$4,040	-\$571	\$43	\$1,648
TELUS Corporation	\$8,873	\$36	\$179	\$1,070	\$8,641	\$21	\$628	\$992
Teck Resources Ltd.	\$2,342	\$236	\$0	\$58	\$2,312	\$200	\$0	\$374
Thomson Reuters	\$6,164	-\$655	\$1,673	\$982	\$5,944	-\$574	\$1,417	\$1,015
Toronto-Dominion Bank	\$5,823	-\$982	\$487	\$3,808	\$5,327	-\$50	\$0	\$3,444
TransCanada Corporation	\$3,208	-\$248	\$14	\$1,536	\$2,591	-\$189	\$294	\$1,538

TABLE 7 S&P/TSX 60 pension plans and shareholder payouts, 2013 and 2014

Company name	2014				2013			
	DB plan assets	DB funding balance	Share repurchases	Dividend payments	DB plan assets	DB funding balance	Share repurchases	Dividend payments
Agrium Inc. (USD)	\$281	-\$73	\$0	\$430	\$258	-\$66	\$498	\$334
Alimentation Couche-Tard Inc. (USD)	\$363	-\$90	\$0	\$65	\$371	-\$88	\$0	\$56
Bank of Montreal	\$7,536	\$32	\$0	\$1,851	\$6,267	\$86	\$675	\$1,896
Bank of Nova Scotia	\$7,323	-\$624	\$320	\$3,265	\$6,647	-\$293	\$0	\$3,075
Barrick Gold Corporation (USD)	\$218	-\$96	\$0	\$232	\$216	-\$72	\$0	\$508
BCE Inc.	\$19,819	-\$1,169	\$0	\$1,893	\$18,082	-\$590	\$0	\$1,795
Bombardier Inc. (USD)	\$8,820	-\$2,143	\$0	\$182	\$8,332	-\$1,623	\$0	\$196
Brookfield Asset Management Inc. (USD)	\$536	-\$91	\$63	\$542	\$662	-\$134	\$388	\$541
Canadian Imperial Bank of Commerce	\$6,796	\$61	\$315	\$1,654	\$6,322	\$321	\$552	\$1,622
Canadian National Railway Company	\$17,761	\$482	\$1,505	\$818	\$16,869	\$1,359	\$1,400	\$724
Canadian Pacific Railway Ltd.	\$11,376	\$16	\$2,050	\$244	\$10,722	\$801	\$0	\$244
Cenovus Energy Inc.	\$139	-\$61	\$0	\$805	\$115	-\$33	\$0	\$732
Eldorado Gold Corp. (USD)	\$2	-\$1	\$0	\$13	\$2	\$0	\$0	\$85
Emera	\$1,205	-\$265	\$0	\$236	\$1,070	-\$183	\$0	\$205
Enbridge Inc.	\$2,062	-\$408	\$0	\$994	\$1,799	-\$104	\$0	\$825
Encana (USD)	\$264	-\$15	\$0	\$202	\$291	\$4	\$0	\$401
Fortis Inc.	\$2,216	-\$388	\$0	\$256	\$1,541	-\$183	\$0	\$237
George Weston Ltd.	\$2,502	-\$52	\$29	\$319	\$2,044	\$27	\$42	\$247
Husky Energy Inc.	\$180	\$1	\$0	\$1,182	\$173	-\$7	\$0	\$1,184
Imperial Oil Ltd.	\$6,807	-\$1,163	\$0	\$441	\$5,872	-\$998	\$0	\$407
Loblaw Company Ltd.	\$2,136	-\$22	\$178	\$496	\$1,709	\$41	\$73	\$259
Magna International Inc. (USD)	\$347	-\$193	\$1,783	\$316	\$328	-\$126	\$1,020	\$284
Manulife Financial Corporation	\$3,442	-\$647	\$0	\$910	\$2,990	-\$577	\$0	\$761
Metro Inc.	\$949	-\$32	\$0	\$101	\$814	-\$27	\$0	\$92
National Bank of Canada	\$3,340	\$179	\$104	\$795	\$2,948	\$128	\$285	\$581
Pembina Pipeline Corporation	\$137	-\$12	\$0	\$269	\$124	\$5	\$0	\$221
Potash Corporation of Saskatchewan Inc. (USD)	\$1,316	-\$87	\$1,065	\$1,141	\$1,252	\$50	\$411	\$997
Power Corporation	\$6,700	-\$1,221	\$3	\$587	\$6,054	-\$509	\$0	\$586
Rogers Communications Inc.	\$1,285	-\$307	\$0	\$930	\$1,037	-\$172	\$21	\$876
Royal Bank of Canada	\$11,351	-\$454	\$113	\$4,211	\$10,266	-\$147	\$408	\$3,810
SNC-Lavalin Group	\$225	-\$82	\$0	\$146	\$163	-\$63	\$0	\$139
Saputo Inc.	\$254	-\$18	\$154	\$175	\$219	-\$38	\$190	\$162
Sun Life Financial Inc.	\$2,988	-\$214	\$39	\$886	\$2,583	-\$89	\$0	\$799
Suncor Energy Inc.	\$3,775	-\$767	\$1,671	\$1,490	\$3,293	-\$598	\$1,675	\$1,095
TELUS Corporation	\$8,480	-\$556	\$612	\$913	\$7,974	\$64	\$1,000	\$852
Teck Resources Ltd.	\$2,228	\$139	\$5	\$518	\$1,991	\$140	\$176	\$521
Thomson Reuters	\$6,470	-\$488	\$1,023	\$1,036	\$5,788	-\$260	\$400	\$1,041
Toronto-Dominion Bank	\$4,805	-\$516	\$220	\$3,188	\$4,177	-\$161	\$780	\$2,647
TransCanada Corporation	\$2,398	-\$260	\$0	\$1,439	\$2,152	-\$72	\$0	\$1,356

TABLE 7 S&P/TSX 60 pension plans and shareholder payouts, 2011 and 2012

Company name	2012				2011			
	DB plan assets	DB funding balance	Share repurchases	Dividend payments	DB plan assets	DB funding balance	Share repurchases	Dividend payments
Agrium Inc. (USD)	\$195	-\$107	\$913	\$115	\$159	-\$113	\$0	\$18
Alimentation Couche-Tard Inc. (USD)	\$25	-\$40	\$201	\$50	\$26	-\$32	\$69	\$33
Bank of Montreal	\$5,802	-\$210	\$0	\$1,419	\$5,338	\$214	\$0	\$1,663
Bank of Nova Scotia	\$5,607	-\$1,071	\$0	\$2,713	\$5,213	-\$221	\$0	\$2,416
Barrick Gold Corporation (USD)	\$207	-\$129	\$0	\$750	\$227	-\$158	\$0	\$509
BCE Inc.	\$17,727	-\$1,815	\$107	\$1,683	\$16,384	-\$1,088	\$143	\$1,520
Bombardier Inc. (USD)	\$7,434	-\$2,545	\$0	\$249	\$6,395	-\$2,847	\$14	\$156
Brookfield Asset Management Inc. (USD)	\$1,141	-\$150	\$106	\$469	\$1,093	-\$30	\$186	\$425
Canadian Imperial Bank of Commerce	\$5,548	-\$298	\$157	\$1,598	\$4,895	-\$78	\$0	\$1,556
Canadian National Railway Company	\$15,811	-\$524	\$1,400	\$652	\$14,719	-\$829	\$1,420	\$585
Canadian Pacific Railway Ltd.	\$9,763	-\$884	\$0	\$223	\$9,215	-\$884	\$0	\$193
Cenovus Energy Inc.	\$98	-\$36	\$0	\$665	\$61	-\$23	\$0	\$603
Eldorado Gold Corp. (USD)	\$2	-\$1	\$0	\$93	\$2	\$0	\$0	\$61
Emera	\$903	-\$418	\$0	\$180	\$722	-\$443	\$0	\$164
Enbridge Inc.	\$1,500	-\$379	\$0	\$690	\$1,355	-\$331	\$0	\$537
Encana (USD)	\$309	-\$48	\$0	\$588	\$275	-\$69	\$0	\$588
Fortis Inc.	\$868	-\$264	\$0	\$216	\$785	-\$233	\$0	\$197
George Weston Ltd.	\$1,847	-\$338	\$1	\$229	\$1,621	-\$438	\$61	\$1,230
Husky Energy Inc.	\$156	-\$33	\$0	\$574	\$147	-\$36	\$0	\$502
Imperial Oil Ltd.	\$5,114	-\$2,222	\$128	\$398	\$4,461	-\$2,185	\$59	\$373
Loblaw Company Ltd.	\$1,532	-\$279	\$16	\$177	\$1,330	-\$355	\$39	\$193
Magna International Inc. (USD)	\$288	-\$214	\$40	\$252	\$259	-\$144	\$407	\$236
Manulife Financial Corporation	\$2,774	-\$822	\$0	\$733	\$2,611	-\$913	\$0	\$717
Metro Inc.	\$730	-\$111	\$0	\$83	\$632	-\$86	\$0	\$77
National Bank of Canada	\$2,613	-\$83	\$75	\$528	\$2,373	\$139	\$834	\$490
Pembina Pipeline Corporation	\$100	-\$21	\$0	\$181	\$89	-\$11	\$0	\$261
Potash Corporation of Saskatchewan Inc. (USD)	\$1,052	-\$172	\$0	\$467	\$887	-\$164	\$0	\$208
Power Corporation	\$4,211	-\$1,109	\$2	\$582	\$3,992	-\$721	\$4	\$574
Rogers Communications Inc.	\$833	-\$334	\$350	\$803	\$684	-\$133	\$1,099	\$758
Royal Bank of Canada	\$9,348	-\$509	\$0	\$3,272	\$8,092	-\$245	\$0	\$3,032
SNC-Lavalin Group	\$157	-\$58	\$7	\$133	\$146	-\$58	\$44	\$127
Saputo Inc.	\$193	-\$41	\$242	\$147	\$197	-\$13	\$215	\$129
Sun Life Financial Inc.	\$2,283	-\$404	\$0	\$699	\$2,158	-\$380	\$0	\$679
Suncor Energy Inc.	\$2,843	-\$1,294	\$1,451	\$756	\$2,499	-\$1,199	\$500	\$664
TELUS Corporation	\$7,147	-\$1,364	\$0	\$774	\$6,751	-\$997	\$0	\$642
Teck Resources Ltd.	\$1,729	-\$255	\$129	\$469	\$1,543	-\$278	\$171	\$354
Thomson Reuters	\$5,173	-\$984	\$168	\$1,024	\$4,991	-\$695	\$326	\$963
Toronto-Dominion Bank	\$3,743	-\$400	\$0	\$1,870	\$3,300	\$159	\$0	\$1,835
TransCanada Corporation	\$1,825	-\$317	\$0	\$1,281	\$1,656	-\$180	\$0	\$1,016

Notes

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2 Ibid.

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7 Department of Work and Pensions, *Security and Sustainability in Defined Benefit Pension Schemes*, February 2017, paras. 102, 156.

8 Department of Work and Pensions, *Security and Sustainability in Defined Benefit Pension Schemes*, February 2017, para. 332. For an overview of the powers of The Pension Regulator and the proposals to expand these powers, see Djuna Thurley, *The Pensions Regulator: Powers to Protect Pension Benefits*, House of Commons Briefing Paper, Number CBP-04368, 21 June 2017.

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- 18 Erica Alini, “Sears Canada to apply to liquidate all remaining stores, affecting 12,000 jobs” *Globalnews.ca*, October 10, 2017 (<https://globalnews.ca/news/3794587/sears-canada-liquidation/> Accessed on October 11, 2017)
- 19 FTI Consulting, “Court File No. CV-17-11846-00CL, SEARS CANADA INC., AND RELATED APPLICANTS: SUPPLEMENT TO THE FIRST REPORT OF FTI CONSULTING CANADA INC., AS MONITOR” Page 3, July 12, 2017 (<http://cfcanada.fticonsulting.com/searscanada/reports.htm> Accessed on October 16th, 2017).
- 20 Including the following dividend payments: \$753.4 mil in 2010, \$101.9 mil in 2012, \$509.4 mil in 2013 and share repurchases: \$42.7 mil in 2010, \$42.0 mil in 2011, \$9.7 mil in 2012. See the Sears Canada Inc Audited Financial Statements from 2009, 2012 and 2014 as archived on SEDAR (www.sedar.com)
- 21 For a more thorough analysis of this case see Cole Eisen, “How a corporate focus on the short term drove Sears into the ground” *The Globe and Mail*, July 30th, 2017 (<https://beta.theglobeandmail.com/report-on-business/rob-commentary/how-a-corporate-focus-on-the-short-term-drove-sears-into-the-ground/article35839929/> Accessed on Oct 11, 2017)
- 22 The accounting rules for reporting deficits in financial reports differ from the actuarial rules for calculating a solvency deficit. However, they are approximate measures and only suggestive of the deficit calculated on a wind-up basis, which would generate greater liabilities than reported using either of the other two methods.
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