What Sears retirees can do about the reduced DB pension

Sears Canada's underfunded pension means retirees get a 19% benefit cut

Jonathan Chevreau November 2nd, 2017

Like Stelco and Nortel before it, thousands of pensioners of Sears Canada are experiencing firsthand what happens to corporate Defined Benefit pension plans when a business fails.

In October, Ontario's Superintendent of Financial Services (FSCO) appointed Morneau Shepell to administer Sears Canada's underfunded pension plan, a first step to winding the plan down in the wave of store liquidations that are now under way.

According to veteran Sears Canada spokesperson Vincent Power, the Sears DB pension is only 81% funded as of June 2017, although changes in interest rates and markets could alter the final figure. If it stands, it means DB plan members would get a 19% benefits haircut, although Ontario residents would have some restitution under the province's Pension Benefits Guarantee Fund (PBGF), which we looked at in detail a couple of columns back. The PBGF guarantees the first $1,000 a month of pension, a figure slated to rise to $1,500 but which has not yet been legislated. Residents of other provinces do not enjoy this compensation, and roughly half of Sears employees were outside Ontario.

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The full story of how Sears Canada imploded is beyond the scope of this column but I refer readers to an excellent summary in the *Globe & Mail* here. Our focus today is on the implications for Sears pensioners.

Sears Canada was founded in 1953 as a joint venture between Sears Roebuck in the U.S. and Robert Simpson (as in Simpson Sears). It has had various incarnations of DB pensions (it also has a Defined Contribution component) but the most recent DB component ceased to exist as of Jan. 1, 2008, Power said. As of the end of 2016, there were 16,921 members in the DB component of the Sears pension plan: 13,121 of which were retirees and 3,025 active or disabled members.

Sears differs from Nortel in that a Canadian subsidiary of a U.S. company is involved and it appears Chicago-based Sears Holdings Corp milked the Canadian unit to the detriment of Canadian pensioners (not to mention the many employees thrown on the unemployment lines without severance.)

Pension advocates fear other domestic subsidiaries of foreign giants may take a cue from the fate of Sears Canada. The retailer filed for protection from creditors in June and lawyers for Sears' retirees had been asking FSCO and Sears Canada to wind down the pension plan since 2014.

Retired actuary Malcolm Hamilton says the wind-down will be a lengthy process, as there are many calculations to perform, reports to file and permissions to be granted. "Any claim that the pension fund has as an unsecured creditor of Sears cannot be fully evaluated until that process plays out [so] the percentage of the wind-up benefits that the fund will be able to pay will not be known for some time. Once the dust settles, the PBGF will cover any reduction in the first $1,000 of monthly pension for members who were employed in Ontario."

The Sears situation is similar to what happened to pensioners at Nortel Networks years ago, says pension administrator Sean Cooper. When companies file for bankruptcy, pensioners are left in limbo: they are considered unsecured creditors, Cooper says, falling in priority below secured creditors like the banks.

But Sears is hardly unique: 30% of similar defined pension plans in Ontario are also underfunded, which shows the importance of keeping an eye on the funding status of your pension plan. “Your pension could be halted if the company goes bankrupt. This can be especially devastating if you’re on a fixed income,” Cooper says.

Bill Jones, director of the Canadian Federation of Pensioners, says Sears is another example of a broken, or partially broken, pension promise. He points to the billions of dollars Sears Canada has been sending to majority shareholder Edward Lampert, chairman of Sears Holdings Corp., while failing to put money in the pension fund against the deficit. As a result, “all the people who are Sears pensioners or are going to become pensioners if they’re active employees and have an entitlement to part of a pension will lose on the order of 19%, and they’ve also lost all their health and dental benefits.”

If you’ve not yet begun to start receiving the Sears pension, an option is to take the so-called Commuted Value of the pension, rolling a lump sum payment over into your RRSP so you have complete control of the assets. In that case, you’d give up the monthly income stream for life that the pension would have provided in the future.

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But if you’re already receiving a pension, this is usually not an option.

“My advice to pensioners is to hang in,” says Mike Campbell, also a director for the Canadian Federation of Pensioners and vice president of the Nortel Retiree and former employees Protection Canada. Except for young pensioners in their 50s who have low life expectancy, Campbell says the way commutations are calculated, it's punitive to take out the commuted value. "I wouldn't recommend it."

In any case, Hamilton doubts the pension fund would be allowed to pay out commuted values while the process is ongoing. Those allowed to commute their pensions will eventually be able to do so, subject to any reductions imposed by the wind-up process and any guarantee provided by the PBGF, once they have the choice. The decision to commute or not would be the same as for any other commutation, he added, and most should consult their financial advisors.

Joe Nunes, president of Actuarial Solutions Inc., says one of many factors in that decision is how well the plan is funded and how the employer approaches it when it's underfunded. Normally, once you have started a pension, you have to stay in the plan and the option of commuting is lost, Nunes says. Some employers give you the choice upon termination of employment, while others provide the choice at the time you start retirement, but there's no legal requirement either way, Nunes says.

Sears retiree Ken Eady, representative for retired Sears employees, is particularly concerned about those who may have smaller pensions. For them, a 19% haircut and the loss of health and dental benefits will be onerous. Over the past five years the group was repeatedly told by the company that it was abiding by the law; asked whether they considered they had a fiduciary responsibility to the pension plan the company responded "we believe we are," Eady says.

"Clearly the pension promise has been broken by the company. I don't like asset-stripping: what matters is that shareholders had a big payday while leaving the pension plan underfunded. The plan is short $260 million, even after $3.5 billion was paid out to shareholders."

Eady adds: "They sold the assets, took the capital and did not make any meaningful investment in the business, including the pension plan. They let the company drift into a very bad spot and stripped it of many revenue-generating assets. If they had invested in the company, built a new online sales platform or other revenue-generating enterprises, Sears would still be operating and we wouldn't be talking about this."

He's also concerned that other Canadian units of foreign companies will look at the Sears Canada situation and emulate the hedge-fund asset-stripping strategy to the detriment of many more Canadian employees and retirees. Many more cases like Sears and there would be huge pressure on the PBGF and by extension the cash-strapped Ontario government.

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