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Dividend payments, pension deficits among topics in new government consultation

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The federal government is asking Canadians to weigh in on a consultation paper that tackles issues related to underfunding, insolvency and pension plans.

The topics open for comment include that dividend payments, share redemptions and executive compensation packages could be restricted under the Canada Business Corporations Act if a company has a large pension deficit.

Another item up for consultation is that employers seeking funding relief could be required to agree to certain conditions, like a prohibition of dividend payments while pension funding relief measures are in place.

"There's a lot of different competing interests about getting access to capital versus protecting the interests of beneficiaries of pension funds that are underfunded, and so it's not like there's an obvious and easy answer on how to solve this," says Joe Nunes, co-founder and executive chairman of Actuarial Solutions Inc. "Everything's going to involve trade-offs in the sense that decisions that help distressed employers ease the journey to continued operation are going to be less favourable to retirees that need their pensions protected at all costs."

Simon Archer, partner at Goldblatt Partners LLP, says this is a welcome consultation paper raising long-standing issues that need to be addressed.

"The big case that's on everyone's mind this year is the Sears case, which is a great example of that dividend issue problem. But of course there are many others that we don't read about," he says.

He highlights that when Sears was paying out dividends it could have been paying off its pension obligations. "In the end, of course, the company filed for bankruptcy with a big pension deficit and pensioners will be bearing the brunt of that even though during the 10 years prior to it there was lots of money and that deficit could have been paid off," says Archer.

A report, published in November 2017 by the Canadian Centre for Policy Alternatives, highlighted that Sears Canada had a $267 million funding shortfall on a windup basis. However, it paid $1.5 billion in dividends and share buybacks since 2010. "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," said the paper.

Archer says when there's a big underfunded portion in the plan and its persistent for some time, it's reasonable for a regulator to be given some degree of power to monitor, to request information and to even require a company to justify certain transactions.

“Sears made it really clear that those powers are needed here — and how exactly they’re developed and what criteria are used are always up for fair and open debate — but it seems to me quite reasonable and even imperative that regulators be given the power to do that and be given the resources to do it effectively.”

Brian Madden, senior vice-president and portfolio manager at Goodreid Investment Counsel Inc., says it would be an unwelcome if these changes were ever implemented. “As an owner of shares, the dividend is kind of sacrosanct,” he says.

For a company that’s really in financial distress, that’s one thing, and in those instances the dividend should probably be suspended or be reduced, says Madden. However, he notes in many cases, companies with underfunded pensions are just seeing the affects of interest rates.

“Almost all pension funds were underfunded five or six years ago when interest rates hit their lows, but realistically these companies were not in financial distress,” says Madden. “So it would have been, I think, a policy error to force them to suspend their dividends.”

When investing, Madden notes he already looks at whether a company has a large pension deficit, but if these provisions were enacted, the pension funded status will receive increased scrutiny from investors and prospective investors.

“It becomes one more very, very, very salient risk factor in owning the company with an immediate and clear linkage to a possible dividend cut, which is one of the worst things a company can do in terms of signaling to the marketplace.”

When it comes to topics like restricting dividends when a company has a large pension deficit, Nunes says the devil’s in the details, and noticing or phasing in would be key.

“If a creditor has lent a company money under some sort of set of terms, and all of a sudden the government decides that the priority for assets in the company is going to shift away from where they stand in the line of creditors and where the pension plan stands, I think the biggest thing from a corporate finance point of view is that lenders be given notice on how the rules are going to change so that they can appropriately adjust how much they lend and at what interest rate they lend to corporations knowing the priority scheme is changing,” Nunes says.

The government’s consultation is open until Dec. 21, 2018.
