Intelligence MEMOS

From: William B.P. Robson

To: Members of Parliament and pension regulators

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Re: **LESSON FROM THE SEARS DISASTER: FUND PENSIONS PROPERLY!**

The bankruptcy of Sears Canada, and the threat that its underfunded pension plan won't pay what it promised, has drawn widespread attention, not least from members of Parliament.

Understandably so. You don't get a second chance at retirement and when your payout suddenly falls, it's a terrible blow.

After the sponsor of an insolvent pension plan has gone bankrupt, moreover, governments have no happy choices. A bailout – taxpayers paying for the actions of an irresponsible employer – would be unfair, and set a terrible precedent. Some want a national pension guarantee fund that would charge premiums and pay out upon failures. But experience in the United States, Ontario and elsewhere shows that those schemes also tax responsible people to cover costs created by irresponsible people. And, as in the Sears case, you can't conjure up insurance for a plan that has already failed.

What about giving pensioners priority over other creditors? That's not a crazy idea – if done prospectively. But it wouldn't address a basic problem illustrated not only by Sears, but by previous pension disasters such as those of Algoma Steel and Nortel.

Whether because of bad economics, bad management, or bad behaviour, defined-benefit pension plans and their sponsors tend to go bust together. The front of a line of creditors fighting for cents on the dollar from a bankrupt employer is better than the back of the line. But fighting in court for cents on the dollar from a bankrupt is not what participants in those plans dreamed of doing in retirement.

The question Sears Canada, Algoma and Nortel – and pension defaults in major US industries, not to mention Detroit, other US cities, and potentially soon US states – ought to prompt is not how to share shortfalls after a collapse, but why these plans had shortfalls in the first place. Advocates for defined-benefit pensions claim these plans reliably provide comfortable retirements at low cost. But they often don't. Why not?

First, because sponsors of defined-benefit pension plans – businesses, governments, and other organizations such as universities – face a temptation. Paying employees a dollar now costs … a dollar! Promising them a dollar in the future can look way cheaper. All you need is the right assumptions. Assume people will contribute to the plan for a long time, assume they won't live too long afterwards – and, critically, assume high and reliable returns on investments in the plan – and that dollar in the future seems to come at a discount.

Why don't regulators stop them? The answer is that most governments yield to the same temptations as do other sponsors of defined-benefit pensions. Ottawa's own plans have assets way short of their liabilities. Most governments give the green light to other employers whose assumptions understate the cost of their pension promises.

The plight of the Sears pensioners, and the dearth of happy options for MPs wanting to help them, recalls the adage that an ounce of prevention is worth a pound of cure. Employers who make pension promises – public or private sector – should fund them. Not just on the basis of convenient assumptions, but on the ability to pay out even when things go wrong. If they won't do it on their own, regulators and voters should force the issue.

It is the right thing to do. We shouldn't need a Sears pensioner to tell us that.

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