KEY TAKEAWAY
As 2011 10-K’s are filed, investors should look to new required disclosures related to multiemployer pension plans. These disclosures will provide users of financial statements with additional information about the plans in which a company participates, the level of the company’s participation in the plans, and the financial health of significant plans. Given declining interest rates and weak equity market performance in 2011, individual companies’ share of these liabilities and the related expenses may increase in 2012 making the new disclosures very useful.

SUMMARY
Background and Required Disclosure
In September 2011, the FASB issued Accounting Standards Update (ASU) No. 2011-09, Compensation Retirement Benefits—Multiemployer Plans (Subtopic 715-80): Disclosures about an Employer’s Participation in a Multiemployer Plan. The ASU requires enhanced disclosures about an employer’s participation in a multiemployer pension plan but does not change the existing recognition and measurement guidance for an employer’s involvement in a multiemployer plan. Employers will continue to recognize their required contribution to the plan as pension or other postretirement benefit cost for the period and recognize a liability for any contributions due at the reporting date, essentially treating a defined benefit multiemployer plan as a defined contribution plan.

According to the Pension Benefit Guaranty Corp. (PBGC) website, “[t]here are about 1,510 active multiemployer defined benefit pension plans, covering about 10.1 million participants.” A multiemployer plan is one in which two or more unrelated employers participate and in which assets contributed by an employer are not specifically earmarked only for its employees. That is, assets contributed by one employer may be used to provide benefits to employees of other participating employers. Plans of this type are commonly used by employers to provide benefits to union employees that may work for multiple employers during their working life and thereby accrue benefits in one plan for their retirement. Because contributions made to the plans are not segregated or earmarked for the employees of the contributing firm, assets contributed by one employer may be used to provide benefits to employees of other participating employers. Further, if a participating employer fails to make its required contributions or drops out of the plan, the unfunded obligations of the plan may be borne by the remaining participating employers.

Previously, disclosures were limited primarily to the historical contributions made to the plans. The new rules will require additional disclosures by employers that participate in multiemployer plans, including:

1. The significant multiemployer plans in which an employer participates
2. The level of an employer’s participation in the significant multiemployer plans, including the employer’s contributions made to the plans
3. The financial health of the significant multiemployer plans, including an indication of the funded status (the most recently available “zone status”, if available, or whether the plan was less than 65% funded, between 65% and 80% funded, or at least 80% funded)
4. The nature of the employer commitments to the plan.

These additional disclosures will help investors better understand an employer’s participation in multiemployer plans as well as better analyze possible commitments and risks from being involved in multiemployer plans. The disclosure requirement related to an indication of funded status, in particular, will help investors understand the financial health of all significant plans in which an employer participates.

While these disclosures will certainly be helpful, we do note that the Board considered requiring additional disclosure related to the estimate of an employer’s withdrawal liability and other proxies for an employer’s proportional share of the plan’s unfunded status. Unfortunately, none of the approaches were deemed sufficiently satisfactory for providing a representative level of an employer’s proportional share of the liability. The new disclosure requirements, therefore, do not include information regarding an employer’s share of the plan’s liability. Additionally, the new disclosure requirements relate only to pension plans and not to multiemployer health and welfare plans.

For public entities, the ASU is effective for fiscal years ending after December 15, 2011 so we would expect to begin seeing these additional disclosures in companies with fiscal year-ends on December 31, 2011.

**Multiemployer Plans are a Major Cost for Some Firms**

The period since the 2008 recession has been very difficult on both single employer and multiemployer pension plans. Declines in equity markets have driven assets lower while declining interest rates have pushed benefit obligations higher. 2011 was likely a difficult year for pension plans as major equity markets around the globe declined or were flat while interest rates in the US declined. The result likely was a decrease in the funded status of many multiemployer plans, which could result in higher cash contributions and expenses in 2012.

Multiemployer pension plans can be a major expense and cash drain for companies. For example, in an Affidavit related to the bankruptcy filing of Hostess, CEO Brian Driscoll cites the burden of its multi-employer pension plans as a key driver of the Company’s bankruptcy. Regarding multiemployer plans, the filing notes:

[Hostess’] cash contribution obligations to these plans go beyond amounts attributable to the retirement benefits for the Debtors' own workforce; they also encompass the contributions attributable to the retirement benefits of the workforces of other employers who have ceased to exist or have otherwise withdrawn from the plans. By
The plans are structured to place the financial burdens of all of the plan's retirees upon those remaining companies that have active union employees. Over the last several decades, the number of companies and the active employee base supporting these pension plans have shrunk significantly, thus increasing the burden on the companies, such as Hostess, that remain.¹

As previously noted, it is not just the ongoing cost of these plans that presents a risk. The additional risk is that companies that remain in the plan will face an increasing burden as other companies drop out or are unable to make required contributions. Hostess itself appears to have ceased making contributions several months prior to its bankruptcy filing.

Kroger Co.'s 2010 10-K filing provides a good example of the type of disclosures we can expect to see from more firms now that these disclosures are required. Kroger appears to have provided these disclosures voluntarily in prior periods:

Multi-Employer Plans

We also contribute to various multi-employer pension plans based on obligations arising from most of our collective bargaining agreements. These plans provide retirement benefits to participants based on their service to contributing employers. The benefits are paid from assets held in trust for that purpose. Trustees are appointed in equal number by employers and unions. The trustees typically are responsible for determining the level of benefits to be provided to participants as well as for such matters as the investment of the assets and the administration of the plans.

We recognize expense in connection with these plans as contributions are funded, in accordance with GAAP. We made contributions to these plans, and recognized expense, of $262 million in 2010, $233 million in 2009 and $219 million in 2008.

Based on the most recent information available to us, we believe that the present value of actuarially accrued liabilities in most or all of these multi-employer plans substantially exceeds the value of the assets held in trust to pay benefits. We have attempted to estimate the amount by which these liabilities exceed the assets, (i.e., the amount of underfunding), as of December 31, 2010. Because Kroger is only one of a number of employers contributing to these plans, we also have attempted to estimate the ratio of Kroger’s contributions to the total of all contributions to these plans in a year as a way of assessing Kroger’s “share” of the underfunding. Nonetheless, the underfunding is not a direct obligation or liability of Kroger or of any employer. As of December 31, 2010, we estimate that Kroger’s share of the underfunding of multi-employer plans to which Kroger contributes was $2.5 billion, pre-tax, or $1.6 billion, after-tax. This represents a decrease in the estimated amount of underfunding of approximately $125 million, pre-tax, or $75 million, after-tax, as of December 31, 2010, compared to December 31, 2009. The decrease in the amount of underfunding is attributable to the strength of the market during the last year and benefit reductions. Our estimate is based on the most current information available to us.

including actuarial evaluations and other data (that include the estimates of others), and such information may be outdated or otherwise unreliable.

We have made and disclosed this estimate not because this underfunding is a direct liability of Kroger. Rather, we believe the underfunding is likely to have important consequences. In 2010, our contributions to these plans increased approximately 12% over the prior year and have grown at a compound annual rate of approximately 7% since 2005. In 2011, we expect to contribute approximately $300 million to our multi-employer pension plans, subject to collective bargaining and capital market conditions. Based on current market conditions, we expect meaningful increases in funding and in expense as a result of increases in multi-employer pension plan contributions over the next few years. Finally, underfunding means that, in the event we were to exit certain markets or otherwise cease making contributions to these funds, we could trigger a substantial withdrawal liability. Any adjustment for withdrawal liability will be recorded when it is probable that a liability exists and can be reasonably estimated, in accordance with GAAP.

The amount of underfunding described above is an estimate and could change based on contract negotiations, returns on the assets held in the multi-employer plans and benefit payments. The amount could decline, and Kroger’s future expense would be favorably affected, if the values of the assets held in the trust significantly increase or if further changes occur through collective bargaining, trustee action or favorable legislation. On the other hand, Kroger’s share of the underfunding could increase and Kroger’s future expense could be adversely affected if the asset values decline, if employers currently contributing to these funds cease participation or if changes occur through collective bargaining, trustee action or adverse legislation.²

As noted, Kroger contributed $262 million to its multiemployer plans in fiscal 2010, which amounts to 12% of the Company’s operating income and 8% of its operating cash flow. Further, the company expects to “meaningful increases” in the expense going forward.

Multiemployer plans can represent a large expenditure for the companies that participate in them and these expenditures are likely to rise in 2012 due to weak asset returns and lower interest rates. Thus, investors should take note of the new disclosures as they can provide good intelligence on the potential impact on a company’s results.

² The Kroger Co. 10-K filing for the fiscal year ended January 29, 2011.