Statement of Scott Henderson, Vice President of Pension Investments and Strategy

The Kroger Co.

On "Private Employer Defined Pension Plans"

U.S. House Ways and Means Committee,

Subcommittee on Select Revenue Measures

Wednesday, September 17, 2014

Chairman Tiberi, Ranking Member Neal, and members of the Subcommittee. My name is Scott Henderson. I am the Vice President of Pension Investments and Strategy for The Kroger Co. ("Kroger"). I have responsibility for Kroger's pension investments, and I serve as a Trustee for two of the largest multiemployer plans in the food industry. My testimony today focuses on the threat that the multiemployer pension crisis presents to Kroger, our employees and our retirees. I hope that my testimony will demonstrate the need for immediate Congressional action to adopt the measures suggested by the National Coordinating Committee for Multiemployer Plans ("NCCMP") in its report titled "Solutions not Bailouts."

I. ABOUT THE KROGER CO.

Kroger is one of the largest retailers in the world. We employ more than 375,000 associates who serve customers in 2,638 supermarkets and multi-department stores in 34 states and the District of Columbia under two dozen banners. The Company also operates 785 convenience stores, 324 fine jewelry stores, 1271 supermarket fuel centers and 37 food processing facilities. Kroger's net earnings margin is approximately 1.5%, reflecting the highly competitive nature of the retail food industry.

Kroger ranks 24th on the list of Fortune 100 companies and has been recognized by Forbes as the most generous company in America. We support more than 30,000 schools and grassroots organizations in the communities Kroger serves. Kroger contributes food and funds equal to 200 million meals each year through more than 100 Feeding America food bank partners.

In the past six years, Kroger has created 40,000 new jobs, and we have hired more than 22,000 veterans. We recently announced our need to fill an additional 20,000 permanent positions. Notwithstanding our positive story, the uncertain fate of the multiemployer system is a huge concern to our associates, our retirees, and our company.

II. MULTIEMPLOYER PLANS AND THEIR STRUCTURAL PROBLEMS

In order to understand the crisis facing the multiemployer pension system and assess potential solutions, it is critical to have some knowledge of the system's basic structure. There are many variations in multiemployer plan designs, asset allocations and actuarial assumptions. A comprehensive picture, however, of the status of the multiemployer system is not hard to see and the outlook is bleak. For the sake of brevity we have endeavored to mention only the essential highlights.

A. General Overview

A multiemployer defined benefit pension plan is a retirement plan to which more than one employer contributes. These plans are jointly managed by a board of trustees and funded pursuant to Collective Bargaining Agreements ("CBAs"). Multiemployer plans were designed to serve as retirement vehicles for smaller employers and industries with mobile workforces, where employment patterns prevented employees from accruing adequate retirement benefits under any one traditional pension plan. In other words, multiemployer plans were established so that workers' pensions could be portable as they moved from job-to-job within the same industry.

Multiemployer plans are subject to the Labor Management Relations Act of 1947, otherwise known as the Taft-Hartley Act. These plans are also subject to the Employee Retirement Income Security Act of 1974 ("ERISA") and the relevant provisions of the Internal Revenue Code of 1986. The plans are required to have equal employer and union representation on the governing board of trustees. In general, the bargaining parties (i.e., the employer and the union) negotiate the terms under which employer sponsors contribute to the multiemployer plan. The board of trustees determines the benefits to be provided by the plan, based on the level of plan contributions and actuarial assumptions. Although the trustees are selected by management and labor, they are required by law to act solely in the interests of plan participants.

There are two fundamental problems with the multiemployer plan system, namely, withdrawal liability and the last man standing rule.

B. Withdrawal Liability

Prior to the enactment of ERISA and the Multiemployer Pension Plan Amendments Act of 1980 ("MPPAA"), an employer's obligation to a multiemployer plan was generally limited to the contribution obligation established in its CBA. Once it made the agreed-upon contribution, the employer had no further liability. Thus, if the employer terminated participation in a multiemployer plan following the expiration of its CBA, the employer did not have any further liability to the pension plan.

MPPAA was designed to address problems with the multiemployer pension plan rules, including the possibility that an employer could terminate participation in a plan without having fully funded its benefits promises. MPPAA required contributing employers that terminated their participation in a plan to make payments to cover their share of any unfunded benefits. This is known as "withdrawal liability."

C. "Last-Man Standing" Rule

When a withdrawing employer fails to pay its portion of the plan's unfunded liabilities – as is commonly the case with employers that file for bankruptcy or simply go out of business –

responsibility for funding these unfunded liabilities is shifted to the remaining contributing employers. This is referred to as the "last-man standing" rule.

Even in those cases where an employer exits a plan and pays 100% of its withdrawal liability, the remaining employers remain obligated for ensuring there is adequate funding in the future to cover plan liabilities attributable to the exiting employer. Thus, if the plan has adverse investment experience, the remaining employers must ultimately fund the benefits of the workers and retirees of the withdrawn employer. For example, assume an employer leaves a plan and pays $100 million in withdrawal liability (representing 100% of the amount it owes) but the plan suffers a 25% investment loss in the following year (as many plans did in 2008). Unless the plan experiences future "excess" investment returns that make up the loss, the "last-man standing" rule requires the remaining employers to make up the $25 million shortfall. In other words, the remaining employers bear the investment (and mortality) risk for benefits attributable to the workers and retirees of the employer that exited the plan (notwithstanding the fact that the employer paid 100% of its withdrawal liability).

D. Implications of Withdrawal Liability and the "Last-Man Standing" Rule

The "last man standing" rule effectively saddles the remaining employers in a multiemployer plan with potential liability for pension obligations of workers and retirees that never worked for the remaining employers, or who may have worked for a competitor of the employers, or who may have worked in a completely different industry than the employers. This shifting of risk to the remaining employers places an unfair burden on these employers, and depending on their financial condition, could threaten their continued viability.

Not surprisingly, the "last-man standing" rule has discouraged the entry of new employers into multiemployer plans. New employers do not want to join a plan that could expose them to future withdrawal liability on benefits earned by employees of other employers, including benefits earned long before the new employer joined the plan.

III. KROGER INVOLVEMENT IN MULTIEMPLOYER PLANS

The structural problems with the multiemployer system, coupled with the recent stock market shocks, have led a number of plans to the brink of insolvency. The potential insolvency of the pension funds our employees rely on is one of the biggest concern Kroger faces.

A. History and Background

Approximately two-thirds of our 375,000 associates are covered by roughly 300 CBAs, making Kroger one of the largest unionized employers in the United States. Kroger's primary union is the United Food and Commercial Workers International Union ("UFCW"). Kroger's other unions include the Bakery, Confectionary, Tobacco, Grain Millers International Union ("BCTGM"), the International Brotherhood of Teamsters ("IBT"), the International Union of Operating Engineers ("IUOE"), the International Association of Machinists ("IAM"), the Service Employees International Union ("SEIU"), the United Steel, Paper and Forestry, Rubber, Manufacturing, Energy, Allied Industrial and Service Workers International Union ("USW"), and the National Conference of Fireman & Oilers ("NCFO").

Kroger contributes to 36 multiemployer defined benefit pension plans. Combined, these plans manage over $70 billion in assets and $100 billion of associated liabilities. Kroger will contribute $250 million in 2014 to these plans. In addition to these annual contributions, Kroger could be required to contribute an additional $1.6 billion over the long-term to fund pension benefits earned under these plans. Kroger is not alone.

Like many retail food employers, Kroger began participating in multiemployer plans in the 1960s – in an era during which its exposure to these plans was limited to the contribution it was required to make during the term of its CBAs. Thus, its decision to participate in these plans was made well before the transformational changes made by ERISA and MPPAA.

By virtue of its distributions operations from warehouses and manufacturing plants to its retail store facilities, Kroger (like a number of food employers) became a contributing employer to trucking industry multiemployer plans decades ago – at a time when trucking companies dominated participation in these plans. Following the dramatic consolidation in the trucking industry since the 1980s, however, some of these plans evolved from trucking-only plans; food and beverage employers now represent the largest segment of contributing employers.

The effect of the market consolidation in the retail food and trucking industry was keenly felt when the 2001 tech bubble burst. The combined effect of the market consolidation and the 2001 losses were exacerbated by the 2008 stock market crash. These market events, together with structural problems inherent in the multiemployer rules, have discouraged new entrants from joining these plans and have led to the current funding concerns.

As described in our annual report, Kroger could be required to make future contributions of an estimated $1.6 billion (in addition to its normal contributions) to fund previously accrued pension benefits under the multiemployer plans in which it participates. Importantly, a large portion of the $1.6 billion that Kroger could have to contribute is attributable to workers and retirees who never worked for Kroger.

B. Self-Help Efforts

In response to the challenges described above, Kroger has been working with its union partners in an attempt to resolve many of these funding issues.

For the 11 multiemployer plans on which Kroger has a trustee, we constantly work with our union counterparts to improve the funded status of plans through a combination of contribution increases, benefit adjustments, investment decisions and administrative savings.

The best example of what can be achieved occurred in 2011. Over time, Kroger had effectively become the "last man standing" in four UFCW multiemployer plans. Kroger associates accounted for over 90% of the active participants in these plans. Together, these four plans had a combined total liability of about $3.5 billion, roughly $1 billion of which was attributable to workers and retirees who had never worked for Kroger (i.e., amounts that were shifted to Kroger as a result of the "last-man standing" rule). The combined funded ratio of these plans was 73% (with over $900 million of unfunded liabilities).

Working with the UFCW and PBGC, we agreed to merge these four plans into one, consolidated plan. As part of the merger, Kroger agreed to fund the liabilities attributable to workers and retirees of employers that previously exited the plans. Kroger also made a long-term commitment (until 2021) to a defined benefit plan that is designed to provide competitive and proportional retirement benefits for career associates covered under the new consolidated plan. In the following 12 months, Kroger contributed $900 million to the new plan to eliminate the underfunding of the consolidated plan. As a result of these contributions, the new consolidated plan's funded status increased from 73% to 100% by January 1, 2013.

More recently, Kroger acted to address the funding deficit of a multiemployer plan in Seattle, Washington, that covered 9,000 supermarket workers. The plan was in critical status under IRS funding standards and was likely to become insolvent. Kroger, the UFCW and the other contributing employers worked together to fashion a merger of this severely underfunded plan into a much larger Seattle-based plan covering 82,000 supermarket workers. The merger was made possible (in no small measure) by Kroger's willingness to remove its liabilities from the troubled plan, transfer them to a new consolidated plan and agree to fully fund these transferred liabilities over the next few years. The parties also agreed to adopt special withdrawal liability rules, and other employers agreed to make special contributions to fund their share of the pre-merger underfunding. The transaction was the subject of a recent press release by the PBGC, which is encouraging the creative use of plan mergers to address underfunding.

Plan consolidations have several immediate benefits. Combining assets in larger allocations among fewer managers produces significant asset management fee savings and potentially better returns. Merging plans also reduces the administrative expense burden of the combined plan compared to the individual plans.

Notwithstanding these efforts, Kroger still faces significant exposure from underfunded plans, as do hundreds of other employers. The current funding structure of multiemployer plans discourages companies like Kroger from addressing those plans in which Kroger is not the dominant contributing employer. This is because the current funding rules effectively prevent employers like Kroger from eliminating their share of plan underfunding, unless the other contributing employers can be persuaded to take similar action (or the plan attempts to address the issue through special withdrawal liability rules and contribution agreements as was done with the Seattle plan).

The actions Kroger took in 2011 would be difficult to replicate for plans in which Kroger is not a dominant employer. Special contributions – such as the $900 million contribution Kroger made to the new consolidated plan – would improve the overall funding of the plan but would effectively benefit all contributing employers to the detriment of Kroger employees. Unless other contributing employers can be persuaded to make special contributions, there is little reason for Kroger to unilaterally fund these plans. To illustrate, if Kroger is an equal participant in a multiemployer plan with four other employers, 80 cents of every additional dollar Kroger contributes towards the current underfunding would serve to reduce the overall plan liability of other contributing employers, and would actually increase Kroger's share of the plan's remaining unfunded benefits if Kroger were to withdraw.

In the case of the new consolidated plan, Kroger took action only after concluding that because it was already the "last man standing," the advantages of plan consolidation outweighed the cost of the additional contribution dollars. While special withdrawal liability rules and contribution agreements (like the Seattle plan) may help some plans, they cannot adequately address the underfunding in most of the plans facing insolvency.

IV. A NUMBER OF PLANS ARE HEADED TOWARDS INSOLVENCY

The sad reality is that many multiemployer funds will become insolvent unless Congress acts to avoid this crisis. According to the PBGC, the pensions of almost 1.5 million participants are at risk as these plans are severely underfunded.[1] These deeply-troubled plans have exhausted the remedies available under current law, and without additional options will become insolvent in the near future.

It is important to note that the failure of these plans will have a much greater impact than the 1.5 million participants covered by these plans. The contributing employers to these plans also contribute to many other multiemployer plans. While Kroger may be able to survive the failure of these plans, many other employers cannot. If these plans fail, the resulting liability that those employers face may force many of them out of business. In turn, this will endanger the other multiemployer plans to which these employers previously contributed. This "domino effect" means that the multiemployer crisis is placing at risk the jobs and retirement benefits of millions of Americans.

V. PBGC INSOLVENCY

In the past, participants in an insolvent plan could count on aid from the PBGC to provide at least a portion of their earned benefits. Without immediate Congressional action, however, this reliance on the PBGC will no longer be possible.

As previously discussed, the remaining employers in a multiemployer pension plan effectively guarantee plan benefits. The PBGC plays a secondary role. Thus, unlike troubled single-employer pension plans (where the PBGC receives the plan's assets, assumes the pension liabilities and pays out benefits in the case of a distressed plan), the PBGC assists multiemployer plans by instead loaning money to the plan to pay benefits once the plan becomes insolvent. When this occurs, the pension payments are immediately reduced to the extent they exceed the PBGC statutory limit (currently $12,870 for a retiree with 30 years of service at normal retirement age).

In effect, the PBGC multiemployer insurance fund acts as a "backstop" to those multiemployer funds that need some financial assistance. Because the remaining employers effectively guarantee plan benefits, the PBGC multiemployer insurance fund was not expected to be relied on to a significant extent. This explains why premiums and the guarantee levels are lower than for the single-employer fund. Although admirable in theory, due to profound changes in demographics and other market factors, the PBGC's multiemployer fund is no longer financially sound. For employers such as Kroger, it is like paying insurance premiums to an insurance company that is projected to go out of business before it pays its claims.

[1] PBGC FY 2013 Projections Report at p. 3.

The PBGC recently confirmed this stark assessment in its "FY 2013 Projections Report" released this past June. The 2013 Projections Report projects the PBGC's deficit for its multiemployer program to equal $8.3 billion and will widen to (on average) $49.6 billion by FY 2023. The Projections Report further states-

> "[b]ased on recent reports it is now clear that, despite the improving economy, [multiemployer plans] will not be able to raise contributions or reduce benefits sufficiently to avoid insolvency. Plan insolvencies -- possibly affecting more than a million of the ten million people in multiemployer plans -- are now both more likely and more imminent than in our last report. When plans fail, many participants experience significant benefit reductions because PBGC's statutory multiemployer benefit guarantees are quite low. Furthermore, even that level of benefits is at risk because PBGC's multiemployer program itself is highly likely to be insolvent within a decade, sooner than previously projected. If and when the program becomes insolvent, the only funds available to support benefits would be the premiums that continue to be paid by remaining plans; this would result in benefits being cut much more deeply, to a small fraction of current guarantees."[2]

If Congress does not act quickly, the question will not be *if* the PBGC becomes insolvent, but *when*. The various government agencies that have reviewed the PBGC's financial information agree that under current circumstances, bankruptcy of the PBGC is inevitable. The PBGC itself has concluded that the average date of most likely insolvency occurs in 2021.[3] The Congressional Budget Office, in its 2014 baseline, concurs with the 2021 date.[4] The U.S. General Accountability Office agreed with the insolvency projections, but noted that "PBGC officials said that the insolvency of [either of two large multiemployer plans] would exhaust the insurance fund in 2 to 3 years."[5]

VI. NCCMP RECOMMENDATIONS AS A SOLUTION

In light of the problems discussed above, management, labor, and multiemployer plans from a variety of industries worked together for almost two years to develop a proposal that could save many of the deeply-troubled multiemployer plans – along with the PBGC and the entire multiemployer system. The final product was a comprehensive package, issued by the NCCMP in February 2013, titled "Solutions not Bailouts." The objectives of the package are simple: (1) Changes are needed to existing rules and must provide reliable retirement income security for participants, and (2) contributing employers must be encouraged to improve the solvency of plans they sponsor by reducing financial risks to the employers.

The "Solutions not Bailouts" recommendations fall into three categories: (i) proposals to strengthen and enhance the current multiemployer system, (ii) measures to assist deeply troubled

---

[2] PBGC 2013 Projections Report at p. 1.
[3] Id. at p. 4.
[4] See CBO's April 2014 baseline for the PBGC. Link: http://www.cbo.gov/sites/default/files/cbofiles/attachments/43887-2014-04-PBGC.pdf

[5] GAO: "Private Pensions: Timely Action Needed to Address Impending Multiemployer Plan Insolvencies", GAO-13-240 (March 2013) at p. 29.

plans, and (iii) new structures to foster innovative plan designs. Enactment of these proposals is critical to the goals of reliable retirement income security and improved plan solvency. For example, the recommendations regarding a new form of multiemployer plans will remove the barriers that discourage employers from joining multiemployer plans today.

To address the funding concerns of plans that are facing an immediate funding crisis, management and labor quickly realized that the only realistic and viable solution is to allow labor and management trustees, working together, to adjust accrued benefits of plan participants. Both sides endeavored to create a proposal that will save the maximum number of plans, retain the highest possible level of benefits, and protect the most vulnerable populations. Thus, the proposal would apply to plans projected to become insolvent within 20 years, or within 15 years if the ratio of retired to active participants is less than or equal to 2:1 (a "deeply troubled plan"). The demographics of some deeply troubled plans are such that even if the benefits of all of the active employees were completely eliminated, the plan would still go insolvent. For these deeply troubled plans, the only realistic way to avoid insolvency and preserve as much of the promised pension benefits as possible is to provide plan trustees the ability to suspend some of the accrued benefits of all plan participants, including retirees. The prospect of reducing retiree benefits is, recognizably bleak, but it is a necessary last resort. Importantly, suspending benefits is not a tool the trustees could wield recklessly.

Benefits could only be suspended if the suspension would allow the plan to avoid insolvency and if the plan sponsor had taken all other reasonable measures to forestall insolvency. The plan sponsor would have to obtain the approval of the PBGC before implementing the suspensions. Even after trustee action, benefits would have to be at least 10 percent above the PBGC guarantee level, and any benefit suspensions would have to be distributed equitably across all populations of participants. Further, the proposal also would limit the ability of the plan to make future benefits increases without first restoring the value of suspended retiree benefits.

In evaluating the NCCMP Recommendations, it is important to remember that it is not a question of benefit cuts versus no benefit cuts. When a deeply troubled plan becomes insolvent, participants' benefits *will unquestionably* be cut. Benefits for retirees would be reduced drastically (to $12,870 per year for a 30-year employee) even if the PBGC was still solvent enough to honor the current level of guarantee. Once the PBGC becomes insolvent, benefits would be eliminated almost entirely. This result is unacceptable. But it is inevitable if no action is taken.

The NCCMP Recommendations offer an alternative – modest changes now that, while still painful, will sustain the system for many years to come. This is the best outcome for all of the parties concerned – retirees, workers, employers and taxpayers.

VII. CONGRESSIONAL ACTION IS NECESSARY NOW

Congress MUST act now. With every passing day the risk increases that benefits will be cut. More importantly, failure to act will mean that some large plans cannot be saved, even if Congress later allows plans to cut benefits. Action now is essential to protect the pensions of hundreds of thousands of hard working Americans. To quote Tom Nyhan, Executive Director of the Central State Pension Fund, from congressional testimony he presented last year -- "it is not a question of if there are going to be benefit cuts. There are going to be benefit cuts. The question is when and how they are going to happen." The NCCMP Commission's proposal on deeply troubled plans, if adopted by Congress, will provide pension fund trustees and bargaining parties the tools necessary to avoid insolvency and thereby stave off the drastic cuts that will otherwise occur. We cannot wait until 2021, or even 2016. By then it will be too late. We need your help now.

VIII. CONCLUSION

Kroger is grateful for the opportunity to participate in today's hearing. We applaud this Subcommittee for its leadership in holding this hearing and addressing the structural problems facing the multiemployer system. We appreciate the opportunity to tell our story, and we look forward to working with you on solutions that will ensure the continued viability of the multiemployer system.