How Safe Are Your Retiree Health Benefits?

As GM Wins Deep Concessions, Worries Grow for Many Workers;

Ways to Tell if Cuts Are Likely

By **ELLEN E. SCHULTZ**
Staff Reporter of THE WALL STREET JOURNAL
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General Motors Corp.'s announcement that it will reduce health-care coverage for its union retirees has retirees and employees all over the country wondering if their own benefits are next.

After all, GM is only the latest in a long list of employers that have announced this year that they will reduce or eliminate retiree coverage, including Sears Holdings Corp. and Visteon Corp. Northwest Airlines Corp. has said in court papers that it intends to cut retiree health benefits. And to save money, other companies may be tempted to follow along.

As the health-care landscape shifts, some new -- and worrisome -- trends are becoming clear: Retiree health coverage may not be extinct yet -- about two-thirds of large employers still provide health coverage to eligible retirees, as do most public employers. But it is evolving in ways that increase costs for retirees and create unexpected groups of winners and losers.

For instance, the retirees most vulnerable to cutbacks are not union retirees -- like those affected by the GM move -- but former salaried employees. And even if your retiree health coverage doesn't disappear, there is a growing danger the costs will rise so high that you can't afford to pay the premiums. What's more, the new Medicare prescription-drug coverage, which was supposed to ease the burden, is not likely to lower costs for most workers.

Here are answers to some of the questions on people's minds:

How safe are my benefits?

It depends on what kind of retiree you are.

SHRINKING BENEFITS

Companies that have recently cut retiree health benefits -- or are considering it:

- Delta

- Northwest

- Sears

- General Motors

- Lucent

- Visteon

- US Airways

The most vulnerable are former salaried employees. The courts have generally allowed employers to reduce or eliminate the benefits for nonunion retirees, even years after they've retired, and even if they were promised the benefits in writing.

General Motors, for example, once promised lifetime health coverage to nonunion retirees, often to encourage them to retire early. But then the company began cutting the benefits of 85,000 salaried retirees, and they sued. In 1998, the Sixth Circuit appeals court ruled that even though GM advised prospective retirees that health coverage would be provided "at GM's expense for your lifetime," a clause in the technical plan summary noted that GM reserved the right to alter the benefits. After that key decision, salaried retirees, including those at Unisys Corp., have steadily lost their cases.

Bottom line: If you're a salaried retiree, or will be one, your employer can cut your benefits, even if promised in writing, as long as the plan has "reservation of rights" language in it.

What if I'm covered by a union contract?

You're safer if you're a union retiree: The courts generally haven't allowed employers to unilaterally cut benefits that are part of a negotiated contract. Still, in recent years, some employers have been arguing in court that the contracts were ambiguous -- specifically, that "lifetime" referred to the life of the contract, not the lifetime of the retiree. While the courts have returned mixed decisions, union retirees are still safer from cuts.

And even a union can seek benefits cuts for retirees in special circumstances. This week, worried that GM might unilaterally cut retiree health benefits, the United Auto Workers asked a court to allow it to voluntarily agree to allow GM to cut the retiree benefits. Normally, a union can't negotiate to reduce the benefits for people who are already retired. But retired auto workers are concerned that if GM were to become insolvent, their benefits would disappear altogether.

What if my employer goes bankrupt?

You lose. While the Pension Benefit Guaranty Corp., a quasi-private insurer, will continue to pay pension benefits, retirees usually lose their health coverage. Companies that have asked bankruptcy courts for permission to eliminate retiree benefits include Kaiser Aluminum & Steel Corp. and Bethlehem Steel.

I'm still working. Will I have coverage when I retire?

Again, if you're a salaried employee of a private company, your employer could probably cut your benefits. Meanwhile, if you change jobs, you'll be unlikely to qualify for coverage: Employers have been increasing the number of years you must work to be eligible, to 15 years from 10, for example. And many, including Lockheed Martin Corp., have eliminated coverage for new hires.

Some employers, like International Business Machines Corp., have adopted savings accounts that enable employees to set aside pretax dollars to fund their share of retiree health

benefits. But in these arrangements, once you retire, you generally have to buy the coverage from your employer, and accept what it charges, which may not be any cheaper than what you'd pay on the open market. Your savings may cover only a few years of benefits.

These types of retiree savings accounts are likely to become more common. Employers benefit, because they can contribute company stock to the funds, instead of cash or other securities. Meanwhile, the assets in the funds, which operate like mini-pension plans, can generate income that offsets costs.

GM has announced it will set up a type of savings program to enable union workers to set aside money to use later, and the auto maker says it will contribute $3 billion to the program over the next five years.

My premiums have quadrupled. Why?

There are several likely reasons. At least half of employers, including General Electric Co., Halliburton Inc. and IBM, have established ceilings on what they will pay for retirees' coverage. Once this cap is reached, all the extra costs may be passed on to the retirees. Thanks to these caps, employers are largely protected from rising health-care costs -- but retirees aren't.

Meanwhile, many employers have begun to segregate retirees into their own risk group, rather than include them in a larger group that includes active workers. When retirees are segregated into their own pool, the per-capita costs rise, because an older, sicker population may need more medical care.

As costs rise, healthy people drop out to get cheaper coverage elsewhere. But sicker retirees, and those with pre-existing conditions that make them uninsurable, remain in the health plan, driving up costs. When Xerox Corp. split the retirees into a separate risk pool in 2003, the move caused retirees' costs to nearly double.

Employers benefit when retirees drop coverage. Not only do they save cash, but they can reverse a liability they have recorded for all the estimated future payments. Under accounting rules, this generates gains that indirectly boost income.

My employer hasn't cut coverage. Am I just lucky?

Yes -- but don't hold your breath. One reason that an employer may not be raising your premiums is that within the past five years it has used surplus pension assets to pay retiree health costs. This is legal, but the tradeoff is that employers who do this aren't allowed to cut benefits by more than 20% over the subsequent five years.

Another reason employers have continued to provide retiree medical coverage is because it's a useful tool to get older workers to leave. A 58-year-old may be reluctant to retire, even with a good pension, if he faces the prospect of buying individual health coverage in the open market. The benefits thus help employers reduce their work force without raising the company's health-care costs; although the person is now classified as a retiree, the actual cost of the coverage hasn't changed.

Will the new Medicare prescription-drug coverage lower the cost of retiree health benefits?

Not for you. Some employers have decided to drop the prescription drug benefit they provided to retirees who qualify for Medicare

Others will continue to provide the coverage, in exchange for billions of dollars in government subsidies. But your costs may still rise.

Here's why: Starting in 2006, the U.S. will reimburse employers for 28% of the cost of retiree prescription-drug spending over $250, up to $1,330 per retiree per year, tax-free.

The subsidy was supposed to encourage employers to continue offering retiree health coverage. But employers can collect the subsidy and continue to cut benefits. The rules, which were crafted with significant input from employer groups, allow employers to count retiree contributions towards the total that qualifies for the subsidy, and lets employers aggregate all their retiree groups.

As a result, an employer can completely eliminate the benefits for some groups, and still collect millions of dollars in government money, according to the federal Centers for Medicare and Medicaid Services. Thanks to the subsidy, GM cut $4.1 billion in retiree liabilities from its books, which represents the amount it anticipates collecting from the government over time.