

June 19, 2009

WEATHERING THE STORM

Options to Remove Liabilities for High Retiree Medical Costs from a Company's Balance Sheet: VEBAs

High legacy costs for retiree medical benefits, along with Financial Accounting Standards Board Standard No. 158, which requires balance sheet recognition of such liability, has forced many companies to face the true size of the retiree medical obligations and to consider ways to reduce or limit costs.

Given the long standing division among the courts regarding the nature of the promise of retiree medical benefits, simply eliminating the benefit has often proved to be unsuccessful and unpredictable. As an alternative to continued litigation some companies have entered into court approved settlements to set up a VEBA ("Voluntary Employee Benefit Association" trust). The VEBA provides a means, if all pertinent requirements have been fulfilled, to remove post retirement benefit obligations from a company's balance sheet.

The VEBA settlements to date have primarily been in big auto and steel, industries which have been plagued with high legacy costs. A VEBA requires the creation of a trust, to be governed by an independent board of trustees. Funding can be provided through a number of alternatives, such as cash, or cash plus promissory notes, or equity securities. Although to date many of the VEBAs have been set up in very large companies, the same approach can be utilized with other entities, who, although not as large, still face the high retiree medical costs.

The creation and structuring of the VEBA must fulfill a number of legal requirements all of which are normally manageable. Depending upon how the retiree medical VEBA is to be funded, there are a number of other approvals that may be required and SEC filings that must be made for companies with registered securities if the settlement agreement is a "material agreement." Further, the VEBA will allow for different accounting treatments of the change. If the company has securities registered with the Securities Exchange Commission, the company's accounting treatment can be verified by obtaining approval of the proposed accounting treatment through the office of the Chief Accountant at the SEC and the appropriate Counsel's office.

Removing the liability for retiree medical costs from a company's balance sheet can improve the debt to equity ratio, relieve the company of burdensome ongoing costs and permit the company to restructure its cost structure to be more competitive.

Communication of a change in retiree medical benefits needs to be approached carefully. Some companies have hired individual retiree health coordinators to help facilitate the retirees to prepare for their switch to Medicare or other individual health insurance and to counsel them regarding what is the best choice for them given their individual health costs historically. Other companies have dealt with the change with communications directed to the retirees and the employees as groups.

There are a number of considerations, notices, and certificates that health plans are required to issue for benefit changes or when coverage terminates under the Employee Retirement Income Security Act that one also needs to satisfy.

Due to the many areas of the law impacted by a change to a retiree medical plan, companies considering making such a change will need to assemble a multidisciplinary team of advisors to be certain that the actions of all are coordinated.

If you would like to obtain additional information on this topic, please contact one of the individuals listed below.

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