VEBA Accounts and Health Insurance

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Overview

• Healthcare affects on the automotive business
  – US vs. Japanese Automotive healthcare costs
  – GM VEBA solution
  – Laws and Contracts governing VEBA accounts
  – History of VEBA accounts and likely success

• US healthcare cost trends and coverage
  – Rising healthcare costs
  – Insured versus uninsured
  – Universal healthcare plan in Massachusetts
US vs. Japanese healthcare costs

• Comparison of healthcare costs
  – GM: $1528/vehicle (2004)\(^1\)
  – Toyota: $201/vehicle (2004)\(^2\)

• Japan’s healthcare system
  – Universal health coverage (compulsory)\(^3\)
  – Two groups: National Health Insurance or Employee Health Insurance
  – Premium is based on salary (\(~4\%\)), half is paid by employer.
GM VEBA background

• GM’s healthcare costs include an unfunded liability of $64 Billion for 1.1 million employees, retirees and dependants.⁴

• Toyota pays US active employees healthcare, but not the huge retiree pool GM is obligated to.

• GM inherited this huge liability from labor negotiations decades ago.⁵
GM VEBA

- As a solution to the unfunded liability, UAW and GM negotiated a Voluntary Employees Beneficiary Association (VEBA) contract.
- The VEBA will allow GM to transfer about $50 Billion in retiree health care obligations to an independent trust managed by UAW.\(^6\)
The VEBA will administer retiree health care benefits
GM will initially pay $29.9 billion into VEBA
Includes $4.37 billion GM convertible note
Healthcare co-payments limited to not more than 3%/yr increase through 2015 and after might increase 4%/yr
Active workers will see diversions in wage increases to help fund VEBA
GM will pay $1.6 billion/year over 20 years
– As long as VEBA is anticipated to remain solvent
What is a VEBA?

• VEBA is a tax-exempt trust whose funds are used to pay eligible medical expenses.\(^{10}\)

• It exists to provide for the payment of life, sick, accident or other benefits to association members or their dependents.

• VEBA is a statutory creation found in IRS Code Section 501(c)(9)\(^{11}\)
VEBA legal criteria

• 26 CFR Sec. 1.501(c)(9) describes criteria that must be met to qualify for VEBA tax-exempt status:
  – a) Organization is employees association
  – b) Membership is voluntary
  – c) Organization provides for the payment of life, sick, accident, or other benefits to its members or their dependents or designated beneficiaries, and substantially all of its operations are in furtherance of providing such benefits
  – d) No part of the net earnings of the organization inures, other than by payment of the benefits referred to in paragraph (c) of this section, to the benefit of any private shareholder or individual.
VEBA upsides

• GM
  – Allows GM to remove uncertainty associated with retiree health care costs and negotiations
  – GM expected to pay $35 billion to get out of $50 billion in obligations
  – Makes GM look more profitable for stock investors\textsuperscript{12}
VEBA upsides

• UAW
  – VEBA takes away uncertainty associated with GM bankruptcy
  – Before, if GM went bankrupt, retiree union workers would get nothing. Now they at least have the funded VEBA.
VEBA downsides

• UAW
  – UAW is new to health care financing business
  – VEBAs have failed before and many predict its downfall\(^1\)^\(^3\)
  – All responsibility is now on UAW shoulders to provide retiree healthcare in face of rising costs\(^1\)^\(^4\)
  – Plan starts off under-funded (at 70%)
    • money will have to grow to cover costs (difficult).
VEBA downsides

• GM
  – Minimal since it is transferring all the liability to UAW/VEBA\textsuperscript{15}
  – possible lawsuits if it fails?
VEBA history and concerns

• Traditional VEBAs date back to 1928\textsuperscript{16}
• VEBAs typically used by large unionized companies
• New twist is that VEBA is being used recently as a vehicle to transfer management of liabilities to unions
  – Other automakers are taking GMs lead in adopting VEBA strategy (Ford, Chrysler)\textsuperscript{17}
VEBA history and concerns

• VEBAs have been in decline recently\textsuperscript{31}
VEBA history and concerns

- VEBA failures
  - Caterpillar and Detroit Diesel VEBAs ran out of cash\textsuperscript{18}
  - Federal class action lawsuit against Caterpillar filed in May 2007
VEBA history and concerns

• Successful VEBAs
  – Navistar VEBA set up in 1992 is still going strong
  – Goodyear and United Steelworkers of America recently set up VEBAs
Rising Healthcare costs

• United States health care costs are expensive and rising
  – US spent over $2.3 trillion on health care in 2007\(^{19}\)
  – 16% of GDP
  – Approximately $7,500 per person\(^{20}\)
  – Japan: average of $1,759 per person, but with 4.5 years longer life expectancy\(^{21}\)
Rising Healthcare costs
Total Expenditure

Exhibit 1: National Health Expenditures per Capita, 1990-2016

Note: Figures from 1990 through 2005 represent historical data; data from 2006-2016 are projected.
Rising Healthcare costs
Total Expenditure

• Health care costs are rising, on average, 2.4 percent faster than GDP since 1970.
• Projections show that by 2016, 20% of GDP will be spent on healthcare.
Rising Healthcare costs
Employee expenses

• Employers are shifting health care costs onto employees.
  – Share of health premium was 14% in 1992 and 22.1% in 2005\textsuperscript{22}

• Combined with the rapid growth in overall premiums means workers are paying much more than they used to.

• Average cost charged to employer for insurance for family of four is $12,100 in 2007
  – Workers contribute $3,300 of that, or 10% more than in 2006.
Rising Healthcare costs
Employer costs per worker-hour

Figure 2: Distribution of Health Insurance Costs per Worker Hour for Employees with Access to Coverage, 1999-2005
Rising Healthcare costs
Employer Costs

• Health insurance expenses are the fastest growing cost component for employers\textsuperscript{23}
• Premiums for employer-based health insurance rose 6.7% in 2007.
• Since 2000, employment based health insurance premiums have increased 100%, while inflation was 24% and wage growth was 21%.
US Insured vs. uninsured

• There is a correlation between high health care costs and uninsured citizens.

• In 2005, the census showed 15.3 percent of the population (44.8 million) did not have insurance\textsuperscript{24}
US Insured vs. Uninsured

Insured vs. Uninsured

Uninsured in 2005

Insured in 2005
Massachusetts health care reform

- Massachusetts is attempting to legislate universal health care\(^{25}\)
  - Mandate requires all adult residents to obtain health insurance\(^{26}\)
    - minimum credible coverage rules
  - State offers subsidized health plans with eligibility requirements
    - (poverty levels, other considerations)
  - Employer contribution cannot discriminate based on pay
  - Fair share contribution requires employers to be charged $295/employee to state health care fund\(^{27}\)
  - Employers must have >25% of full time employees enrolled in group plan or pay >33% of premium costs for all full time employees.
Massachusetts health care reform

• It is important, because outcome could help decide how to handle national health care.
• The plan is expected to cost $1.2 Billion over three years
  – New funding will come from employer contributions and General Fund revenues
  – There is concern this is not enough money and could face gap of $147 million this year\textsuperscript{28}
  – Because so many are signing up for subsidized care, costs are projected to skyrocket $400 million in 2009\textsuperscript{29}
• However, although Romney touts it as a success from his time as governor, it is still too early to tell.
  – Plan went into effect July 1, 2007\textsuperscript{30}
Questions?
References

5. Appleby, Jule and Carty, Silke Sharon. “Ailing GM looks to scale back generous health benefits” USA Today. (http://usatoday.com)
References