

GAO

Report to the Honorable  
William J. Coyne, House of  
Representatives

August 1991

# EMPLOYEE BENEFITS

## Effect of Bankruptcy on Retiree Health Benefits



144864

**RESTRICTED**—Not to be released outside the  
General Accounting Office unless specifically  
approved by the Office of Congressional  
Relations. **RELEASED**

---

---

**Human Resources Division**

B-233532

August 30, 1991

The Honorable William J. Coyne  
House of Representatives

Dear Mr. Coyne:

This report responds to your request for information about the effect of employer bankruptcy on retiree health benefits. As agreed with your office, the report includes information on selected bankrupt companies' continued provision of health benefits to their retirees and the extent to which the Retiree Benefits Bankruptcy Protection Act of 1988 and title X of the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) have helped protect their health benefits. We also include information requested by Representative Bruce F. Vento on the effects of bankruptcy on active workers and retirees (participants) in company health plans when the companies have assumed the risk of paying health claims directly (self-insure) rather than purchasing insurance.

---

**Results in Brief**

Almost half of the 40 bankrupt companies we surveyed terminated retiree health benefits, leaving 91,000 retirees responsible for their own health coverage, either permanently or for periods ranging from 1 to 16 months. The laws designed to protect retiree health benefits in bankruptcies did not prevent companies from terminating benefits because the firms either

- were not subject to the U.S. bankruptcy code, which provides protection for retirees' health benefits (most of these firms were banks or savings and loans);
- were permitted by law to terminate benefits because they had terminated active workers' benefits as well; or
- had the approval of the bankruptcy court to do so, as provided for by law.<sup>1</sup>

Once a company enters bankruptcy, there is limited opportunity to secure retirees' health benefits. Therefore, we believe that any future effort to increase the security of these benefits must address such issues as advance funding of benefits.

---

<sup>1</sup>In addition, two companies terminated benefits without court approval.

Retirees from companies that self-insured were more likely to have unpaid claims for covered health services received before the plan terminated than retirees from firms offering coverage through insurance companies or health maintenance organizations.<sup>2</sup> Of 11 self-insuring companies that terminated coverage, 3 initially did not fully reimburse participants. In contrast, none of the eight firms that purchased insurance reported having retirees with unpaid claims at the time they terminated benefits.

## Background

About 9 million retirees are currently enrolled in company group health plans, which provide them and their dependents with needed medical services.<sup>3</sup> For the estimated 3.5 million retirees under the age of 65, these health benefits are especially important, as most are not yet eligible for Medicare. The company plans give retirees and their dependents access to hospitalization, physician, and other health care services at less expense than if purchased individually. Some companies provide health coverage by paying premiums to insurance companies or health maintenance organizations; others self-insure.

But recipients of retiree health benefits do not enjoy the comprehensive protection given to participants in defined benefit pension plans.<sup>4</sup> Retiree health benefits are specifically excluded from the protection provided to pension benefits under the Employee Retirement Income Security Act of 1974 (ERISA). Unlike the situation with pensions, companies need not give workers nonforfeitable rights to accrued benefits (vesting) or set aside funds to help pay for health coverage when workers retire (advance funding). Instead, companies generally fund retiree health benefits out of current revenues. Nor are retiree health benefits federally insured, as are pension plans. (Under ERISA, the Pension Benefit Guaranty Corporation [PBGC] guarantees payment of pension benefits in the event the company terminates its pension plan with insufficient assets to pay promised benefits.)

Although the Congress has not legislated comprehensive retiree health benefit protection standards, it has acted to protect the health benefits of retirees whose companies file for bankruptcy. Effective July 1, 1986,

<sup>2</sup>Health maintenance organizations contract with individuals or companies to provide or assure delivery of health care services to participants, who pay a fixed premium.

<sup>3</sup>Employee Benefits: Trends in Retiree Health Coverage (GAO/T-HRD-90-51, July 27, 1990).

<sup>4</sup>In a defined benefit plan, pension benefits are established in advance by a formula that is generally based on such factors as years of employment, age, and compensation.

---

COBRA required companies that file for bankruptcy under title 11 of the U.S. Code<sup>5</sup> to offer retirees continued access to health benefits. However, an employer filing for bankruptcy may modify or terminate retirees' health benefits if it treats its active workers the same way. Companies providing continued coverage can charge retirees up to 102 percent of what would normally be the combined employer and employee cost for coverage.

Another law, the Retiree Benefits Bankruptcy Protection Act, effective June 16, 1988, restricts certain bankrupt companies' ability to modify or terminate retiree health benefits. If they wish to do so, companies filing under chapter 11 must receive court approval or reach agreement with representatives of the retirees affected. Otherwise, benefits continue to the retirees as they were before bankruptcy. If companies violate the provisions of either law, retirees may take civil action to enforce their rights.

---

## Scope and Methodology

To identify bankrupt companies with retiree health benefits, we compared a list of bankrupt companies with defined benefit pension plans provided by PBGC with data from annual reports filed with the Internal Revenue Service.<sup>6</sup> By matching these two data sources, we identified 163 companies that reportedly offered retiree health benefits and had filed for bankruptcy or some other form of legal protection from creditors between October 1, 1983, and December 31, 1990. Of these, we found that 109 should not have been included in our survey (see app. I).

Of the remaining 54 companies, we surveyed 40 by telephone to obtain information on their retiree health benefits. Fourteen companies either could not be contacted or declined to participate. Collectively, the 40 companies had about 121,000 retired participants. Twenty-nine companies had filed for chapter 11, none for chapter 7. The other 11 filed for protection from their creditors under the federal and state laws that regulate their businesses (see p. 7).

---

<sup>5</sup>Companies generally file under either chapter 7 or 11 of title 11. Under chapter 7, the assets of a business are liquidated and the debts discharged in full. Under chapter 11, a business is protected from its creditors while it attempts to reorganize to make a fresh start.

<sup>6</sup>ERISA requires most employee benefit plans to file annual reports showing financial and demographic data. Plans report by using the form 5500 series, "Annual Return/Report of Employee Benefit Plan."

---

In addition, we interviewed officials from the Administrative Office of the U.S. Courts' Bankruptcy Division, the Securities and Exchange Commission, and PBGC. We also interviewed union officials, retiree health benefit trust administrators, and retirees who lost their health benefits after their employer filed for bankruptcy.

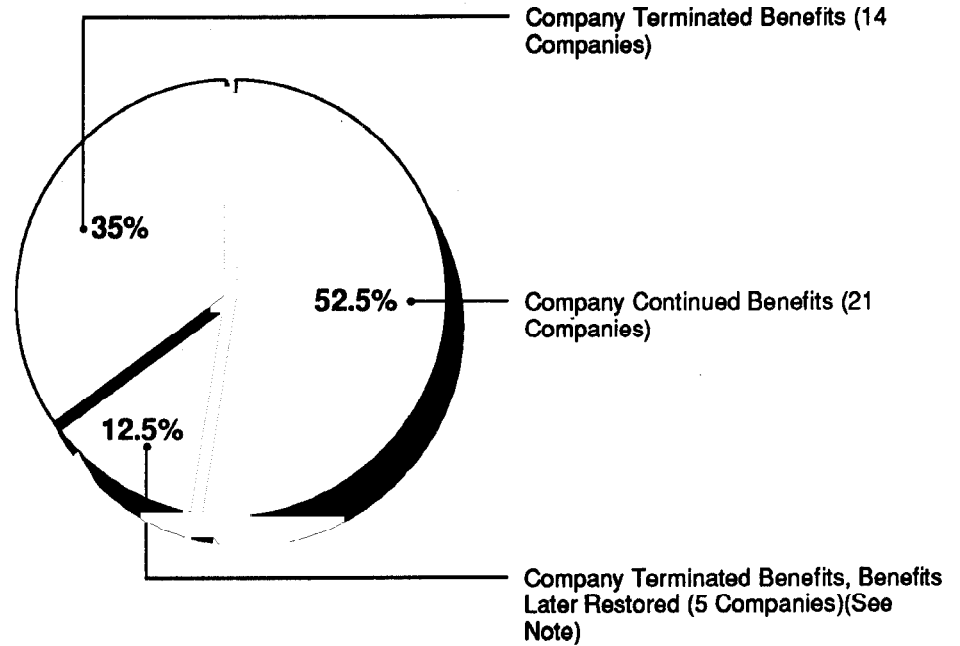
We performed our audit work between January and April 1991. Although we did not independently verify the data companies provided, we did our work in accordance with generally accepted government auditing standards. The results of our survey apply to the 40 companies interviewed and may not be representative of other bankrupt companies. (See app. I for details of our survey methodology.)

---

## Coverage Terminated by 19 Companies

Nineteen companies, nearly half of the 40 surveyed, terminated their retiree health benefits after filing for bankruptcy. At one company, health coverage was reinstated within a month; at four others, coverage was eventually provided through company-funded trusts, as part of the bankruptcy settlement. Twenty-one companies continued providing health coverage to their retirees. (See fig. 1.)

**Figure 1: Nearly Half of Companies Terminated Benefits**



Note: In four cases benefits were provided through the establishment of trusts. In the fifth case the company restored benefits.

At the 19 companies, health benefits were discontinued for about 91,000 retirees. One of these companies terminated benefits for about 60,000 retirees, but restored coverage within 30 days. At 4 of the 19 companies, trusts were established to help finance benefits, but only after retirees had been left without coverage for as long as 16 months. These companies initially terminated retiree benefits for about 28,000 retirees, but the bankruptcy court approved the establishment of trusts to provide funding for coverage as part of the bankruptcy settlement. In each case, unions representing the retirees advocated creation of the trusts, which will partially finance health coverage for the retirees, their spouses, and dependents until the funds are exhausted. Officials associated with two of the trusts said that the funds may be depleted within a few years, leaving the retirees responsible for the entire cost of their health coverage.

---

Benefits were never restored at 14 of the companies, which terminated benefits for 3,400 retirees. The benefits were terminated, officials from some companies told us, because the company either

- lacked unsecured assets to pay retiree benefits,
- abandoned its attempt to reorganize and was liquidated, or
- was bought out while in bankruptcy and the purchasing company did not continue the retiree health benefits.

Despite bankruptcy, not all companies dropped their retiree health benefits. Twenty-one companies continued coverage for about 30,000 retirees. Of the 21, 18 gave retirees the same range of health benefits at the same cost as before the bankruptcy. The other three companies, as well as the four that reinstated health benefits through trusts, required retirees to pay more for health coverage and/or provided them with fewer health services. For some retirees, the increased cost was substantial. For example, before bankruptcy one company offered health plans at no cost to its retirees. A trust now continues to provide benefits, but some retirees pay premiums of up to \$150 per month. Furthermore, some health care services were dropped, such as dental and vision coverage.

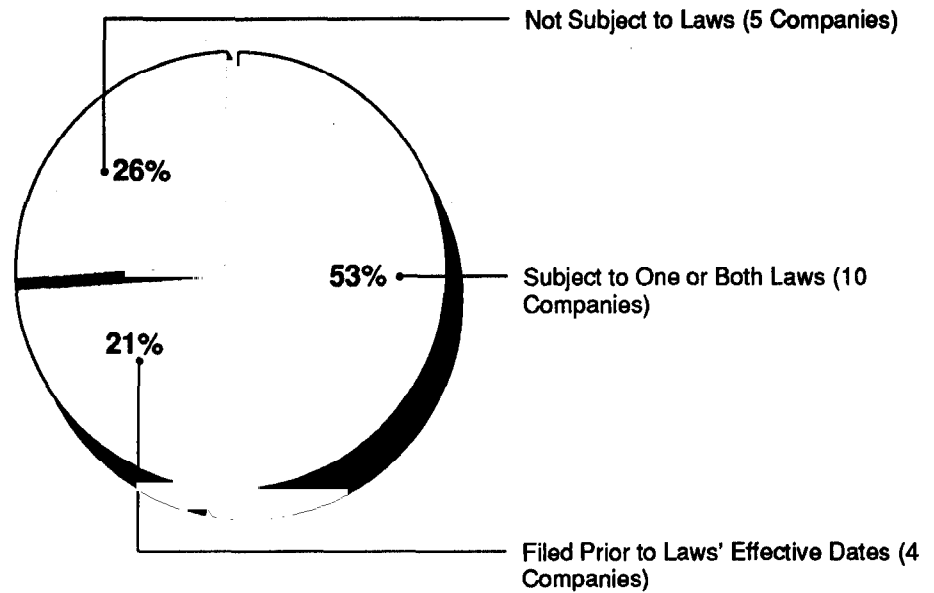
---

## Laws No Guarantee of Continued Coverage

The laws enacted to protect retiree health benefits in bankruptcies did not prevent terminations in all the circumstances we examined. Certain businesses—banks, savings and loans, and insurance companies—are not covered by the laws. Other companies filed for bankruptcy before the laws' effective dates. (See fig. 2.) Even when employers were subject to these laws, retirees sometimes lost their benefits.



**Figure 2: Laws Designed to Protect Retiree Health Benefits Did Not Apply to All Companies Terminating Benefits**



Of the 19 companies that terminated retiree health benefits, 5—banks or savings and loans—were not subject to either COBRA or the Retiree Benefits Bankruptcy Protection Act.<sup>7</sup> These firms terminated the health benefits of over 500 retirees. The policies of both the Federal Deposit Insurance Corporation and the Resolution Trust Corporation are to terminate retiree health benefits when taking control of a bank or savings and loan in order to preserve these institutions' assets, according to officials of the Corporations. Both Corporations have the authority to terminate such contracts under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989.

Of the other 14 companies, 10 had filed for bankruptcy or some other form of protection from creditors after COBRA and/or the Retiree Benefits Bankruptcy Protection Act took effect. All were subject to COBRA, with four also subject to the Bankruptcy Protection Act. All but two terminated coverage as provided for under these laws. Five of the six companies subject only to COBRA, with about 26,400 retirees, ceased benefits because they either went out of business or terminated health benefits

<sup>7</sup>Banks are regulated by the Federal Deposit Insurance Corporation; savings and loans are subject to laws administered by the Resolution Trust Corporation. Insurance companies are regulated by state laws.

---

to their active workers, thus satisfying the law's provisions.<sup>8</sup> Of the four companies subject to both laws, two terminated benefits as provided for under the law. However, the other two terminated health coverage without court approval.

The two companies that did not comply with the Retiree Benefits Bankruptcy Protection Act provisions stopped providing coverage because they had no unsecured assets with which to pay benefits, according to officials associated with them. Recent court decisions have upheld retiree health terminations where the firms had no unsecured assets to pay benefits. While information on one of the companies was unavailable,<sup>9</sup> an attorney representing the retirees of the second company told us it terminated benefits for about 1,700 retirees, leaving them without company-sponsored coverage for about 6 months. Coverage later was reinstated through a trust established as part of the bankruptcy settlement.

---

## Self-Insured Plans More Likely to Leave Unpaid Health Claims

Of 11 companies that self-insured health benefits and terminated coverage, 3 initially failed to reimburse participants for care provided before the terminations. But the eight companies that terminated benefits financed through insurance companies or health maintenance organizations reported leaving no claims for health services unpaid at the time of the termination.

For participants from the three self-insuring companies, the subsequent reimbursement ranged from full to none. Their unpaid health claims totaled about \$2.5 million. Through the bankruptcy settlement, some participants received reimbursement—one company provided total reimbursement of \$750,000 as part of the settlement; another made partial settlement of 29 percent of the \$1.5 million in claims. But the third company paid none of the \$250,000 in claims. Attorneys representing the participants from the two companies that did not provide full reimbursement said that health care providers, including doctors and hospitals, were seeking payment directly from the participants for these unpaid medical services. In one instance, a hospital forced the sale of a participant's home to get payment.

---

<sup>8</sup>The sixth company reinstated coverage within 30 days.

<sup>9</sup>During our survey, this company went out of business, and we were unable to obtain additional information.

---

## Conclusion

Protecting retiree health benefits is difficult once a company enters bankruptcy. Retiree health benefits are not federally insured, nor are employers required to advance fund health benefits. Thus, once a company is in bankruptcy, funds may not be available to provide for continued retiree health coverage, and retirees risk losing this coverage. Furthermore, not all companies are subject to the laws designed to protect retiree health benefits in bankruptcy. Even when they do apply, these laws allow companies to terminate or modify benefits under certain circumstances.

The Congress, companies, and the courts have limited opportunity to secure retirees' benefits after a company enters bankruptcy. Therefore, we believe that any future effort to increase the security of retiree health benefits must, of necessity, address such issues as advance funding of benefits. In previous reports and testimony,<sup>10</sup> we discussed options the Congress could consider if it decides steps should be taken to increase the security of retiree health benefits.

---

We did not obtain agency comments as this report does not deal with the operations of a federal agency. As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after the issue date. At that time, copies will be sent to interested parties. If you or your staff have any questions about this report, please call me at (202) 275-5365. Other major contributors are listed in appendix II.

Sincerely yours,



Gregory J. McDonald  
Associate Director,  
Income Security Issues

---

<sup>10</sup>Retiree Health: Company-Sponsored Plans Facing Increased Costs and Liabilities (GAO/T-HRD-91-25, May 6, 1991); Employee Benefits: Company Actions to Limit Retiree Health Costs (GAO/HRD-89-31 BR, Feb. 1, 1989).

---

# Contents

---

Letter		1
Appendix I		12
Survey Design and Methodology	Data Base Developed From Government Files	12
	Three-Quarters of Firms Responded	13
	GAO-Designed Questionnaire, Computer-Aided Survey Method Used	13
Appendix II		14
Major Contributors to This Report		
Related GAO Products		16
Table	Table I.1: Initial and Adjusted Universe Size and Survey Response Rate	13
Figures	Figure 1: Nearly Half of Companies Terminated Benefits	5
	Figure 2: Laws Designed to Protect Retiree Health Benefits Did Not Apply to All Companies Terminating Benefits	7

---

## Abbreviations

COBRA	Consolidated Omnibus Budget Reconciliation Act of 1985
ERISA	Employee Retirement Income Security Act of 1974
GAO	General Accounting Office
PBGC	Pension Benefit Guaranty Corporation



# Survey Design and Methodology

---

To determine the effect of bankruptcy on retiree health benefits, we identified and surveyed companies that offered retiree health benefits and filed for bankruptcy. We designed a telephone questionnaire and used it to contact our adjusted universe of 54 firms, of which 40 responded.

---

## Data Base Developed From Government Files

The most complete information on companies filing for chapter 7 or 11 bankruptcy is maintained by the Administrative Office of the U.S. Courts' Bankruptcy Division. This data base contains no information on the employee benefits bankrupt companies provide; conversely, the 5500's most plan sponsors file with the Internal Revenue Service contain information on health benefits, but not on company bankruptcies. As there is no data base with information showing bankrupt companies that offered retiree health benefits, we attempted to create our own by cross-matching information from the two data sources. However, the limited automated data maintained by the Administrative Office did not include employer identification information, which precluded us from cross-matching the bankruptcy data with employee benefits information.

In researching alternative data sources on bankruptcy filing, including those maintained by the Securities and Exchange Commission, we determined that PBGC has a data base with information on bankruptcy filing<sup>1</sup> that also contains automated employer identification information. This enabled us to cross-match PBGC's data with that from the 5500's, but resulted in our data set being limited to companies that had defined benefit pension plans.

PBGC provided a list of companies that had defined benefit pension plans and had filed for bankruptcy or taken similar action between October 1, 1983, and December 30, 1990. Using employer identification numbers from PBGC files, we obtained data about these companies from their forms 5500 filed with the Internal Revenue Service. After reviewing the forms, we identified 163 companies that reported having health plans with retired participants.

---

<sup>1</sup>PBGC requires defined benefit pension plans to report certain changes in the plan sponsor's ownership or financial condition, including a sale of the business, voluntary liquidation, and bankruptcy.

## Three-Quarters of Firms Responded

In attempting to contact each of the 163 companies by telephone, we found that 53 should not have been included because they either had not filed for bankruptcy or did not offer retiree health benefits when they filed for bankruptcy. Another 51 companies were apparently no longer in business, as they had no current telephone listing or their numbers had been reassigned to other businesses, and 5 more had been included with parent companies' responses. Thus we contacted an adjusted universe of 54 firms, of which 40 (74.1 percent) responded, as table I.1 indicates. We were unable to contact 12 of the 14 nonrespondents despite repeated attempts; 2 companies declined to participate in our survey.

**Table I.1: Initial and Adjusted Universe Size and Survey Response Rate**

Initial universe	163
Companies excluded because they were:	
Not in bankruptcy or retiree health benefits not offered	53
No longer in business	51
Included with parent company <sup>a</sup>	5
Total excluded	109
Adjusted universe	54
Number of respondents	40
Percent responding	74.1

<sup>a</sup>The information on five subsidiary companies was included as part of the parent companies' responses.

## GAO-Designed Questionnaire, Computer-Aided Survey Method Used

To ensure consistency in the survey data we obtained, we designed a telephone questionnaire. Through it, we collected information on the effect of bankruptcy on retirees' health benefits, companies' compliance with the bankruptcy laws designed to protect retiree benefits, and the effects of self-insuring health coverage. Specific data obtained included the number of retirees enrolled in company-sponsored health plans, methods companies used to finance health plans (through insurance companies or self-insured), changes made to health plans as a result of bankruptcy, and reasons why companies may have terminated retiree health benefits. After pretesting the questionnaire during December 1990 and January 1991, we modified it for clarity. Using a computer-aided telephone interview program, in which responses were entered directly into a computer, the interviewers conducted the survey between January and April 1991.

---

# Major Contributors to This Report

---

**Human Resources  
Division,  
Washington, D.C.**

Robert F. Hughes, Assistant Director, (202) 535-8358  
Cynthia M. Fagnoni, Assignment Manager  
Andrew K. Bhak, Evaluator  
John G. Smale Jr., Social Science Analyst

---

**San Francisco  
Regional Office**

Margie K. Shields, Regional Management Representative  
James E. Hampton, Evaluator-in-Charge  
Deborah A. Moberly, Evaluator  
RoJeanne W. Liu, Evaluator

---

**Dallas Regional Office**

Charles M. Vrabel, Evaluator





---

# Related GAO Products

---

Retiree Health: Company-Sponsored Plans Facing Increased Costs and Liabilities (GAO/T-HRD-91-25, May 6, 1991).

Employee Benefits: Trends in Retiree Health Coverage (GAO/T-HRD-90-51, July 27, 1990).

Employee Benefits: Extent of Multiemployer Plan Retiree Health Coverage (GAO/HRD-90-132, July 17, 1990).

Employee Benefits: Extent of Companies' Retiree Health Coverage (GAO/HRD-90-92, Mar. 28, 1990).

Employee Benefits: Companies' Retiree Health Liabilities Large, Even With Medicare Catastrophic Insurance Savings (GAO/T-HRD-89-29, June 14, 1989).

Employee Benefits: Companies' Retiree Health Liabilities Large, Advance Funding Costly (GAO/HRD-89-51, June 14, 1989).

Employee Benefits: Company Actions to Limit Retiree Health Costs (GAO/HRD-89-31BR, Feb. 1, 1989).

Future Security of Retirees Health Benefits in Question (GAO/T-HRD-88-30, Sept. 15, 1988).

---

### Ordering Information

The first five copies of each GAO report are free. Additional copies are \$2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

U.S. General Accounting Office  
P. O. Box 6015  
Gaithersburg, MD 20877

Orders may also be placed by calling (202) 275-6241.

United States  
General Accounting Office  
Washington, D.C. 20548

Official Business  
Penalty for Private Use \$300

First-Class Mail  
Postage & Fees Paid  
GAO  
Permit No. G100