

*Health Reimbursement Accounts (HRA):
Funding for the Future*
Association of Chief Business Officials
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Health Reimbursement Accounts

A Defined Contribution Plan: An Alternative Retiree Medical Program



Retiree Health Care

If your Community College is typical, your employees fall into the following categories:

- Current Retirees receiving district-paid retiree benefits
- Current Employees vested for district-paid retiree benefits
- Current Employees partially vested for district-paid retiree benefits (vesting schedule)
- Current and Future Employees not yet vested for district-paid retiree benefits (“cliff” vesting)

All the employees falling into these categories will cause a liability to be incurred to the district under GASB 45



Retiree Health Care

In addition, your Community College may also have employees that don't qualify for district-paid benefits:

- Current Employees that are not eligible to receive district-paid retiree benefits
- Future Employees that will not be eligible to receive district-paid retiree benefits

All the employees falling into these categories will not cause a GASB 45 liability, as no future benefits are payable



Retiree Health Care

For Retirees/Employees that may be eligible to receive district-paid retiree benefits, district concerns are:

- GASB 45 costs continue to rise, as health care costs increase
- The “Defined Benefit” obligation makes it difficult to predict future costs
- Cost increases are unsustainable at the current rate of increase

For Employees that don’t qualify for district-paid retiree benefits, their concerns are:

- No retirement benefits, nor ability to accumulate funds for retiree health care costs on a tax-preferred basis

What is the Solution?



An Alternative Approach

Current Retirees will probably wish to remain in the district's Defined Benefit Plan, but other employee groups may be interested in an Alternative Approach:

- Some current Employees that are vested, partially vested, or soon-to-be vested for district-paid retiree benefits may not be in need of these benefits, thus might be interested in a Buyout of future district-paid benefits.
- Current Employees not eligible for district-paid retiree benefits and retiring before age 65 are often in need of a “Bridge” plan.
- Current and Future Employees that don't qualify for district-paid retiree benefits are in need of a tax-preferred way of accumulating funds for post-employment health care costs.

Solution: An HRA



What is an HRA?

- An HRA is a Health Reimbursement Account, a form of a Defined Contribution Plan.
- Health Reimbursement Accounts (HRAs) were created by IRC 105 & 106 and have been available since 1954.
- HRAs are set up and funded by an employer to pay or reimburse certain medical expenses incurred by individual employees/retirees.
- Employees do not contribute unless negotiated on a mandatory, total group basis.
- Flexible, pre-tax contributions accumulate tax-free.



What are Eligible Expenses?

- IRC 213(d) Expenses
 - Same as Section 125 Expenses
 - Non-reimbursed Medical, Dental, Vision Expenses
- Retiree Medical Insurance Premium
- COBRA Premium
- Medicare and Medicare Supplement Premium
- Qualified Long Term Care Premium



HRA: Employer Advantages

- Employer retains ownership of district-contributed funds- i.e. nonvested assets. A vesting schedule can be implemented to encourage employee longevity.
- Contributions to individual employee accounts are not subject to employment tax – considered health plan contributions.
- Employer determines amount of district contribution
 - Flat Amount
 - % of Salary
- No GASB Liability for Defined Contribution Plans



HRA: Employee Advantages

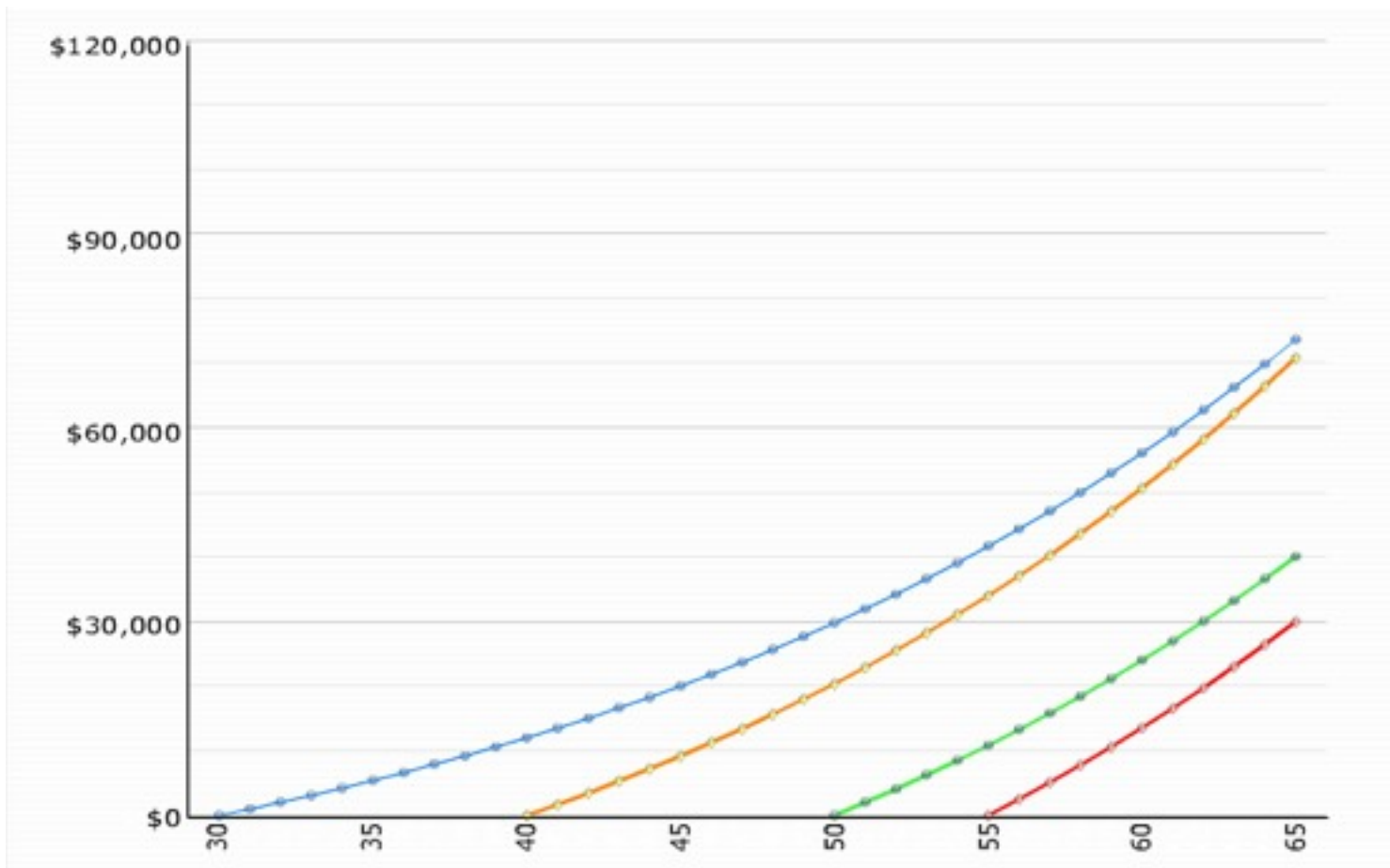
- Tax-favored contributions and withdrawals if used for qualified medical expenses (only vehicle available)
- Can be used to purchase Long Term Care with pre-tax dollars (only vehicle available)
- Unused account balances roll over from year to year

NOTE: The Employee Benefits Research Institute finds that a couple both age 65 today living to average life expectancy could need as much as \$230,000 to cover insurance premiums and out-of-pocket expenses during retirement, **beyond** that covered by Medicare



Example Plan Design

Accumulation of HRA Accounts – 4% Interest



2% of Salary with No Salary Increase



Example Plan Design

Accumulation of HRA Accounts – 4% Interest

➤ 2% of Salary with No Salary Increase

Current Age	Retirement Ages			
Current Salary	50	55	60	65
30	\$ 29,778	\$ 41,646	\$ 56,085	\$ 73,652
\$ 50,000				
40	\$ 20,410	\$ 34,040	\$ 50,623	\$ 70,798
\$ 85,000				
50	N/A	\$ 10,833	\$ 24,012	\$ 40,047
\$ 100,000				
55	N/A	N/A	\$ 13,541	\$ 30,015
\$ 125,000				



Why are \$\$ needed? Trends...

- Tax rates are likely to increase
- Medicare costs are likely to increase
- Health Care Reform is unlikely to provide 100% coverage for all health care needs
- Better technology, and people are living longer
- Most individuals haven't saved enough for retirement



HRA Implementation Options

Different Cohorts have different needs:

- New hires after effective date of the plan can be required to participate
- Active eligible vested employees can be given option of current district plan or new HRA plan
- New HRA plan can be created for active eligible non-vested employees
- Bridge Plan for early retirees
- Active, eligible vested employees are given one time buyout offer to opt-out of retiree medical benefit



HRA Retiree Health Buyout Option

- Eligible Active Employees can be given a one time irrevocable option to receive a buyout and opt out of current retiree benefit.
 - The buyout offer would be as negotiated
 - Buyout paid into HRA (Also can be used in conjunction with a SERP)
 - HRA account balance available at time of retirement from the College and receiving STRS or PERS retirement.



Retiree Buyout Employer Savings Example

Actuarial Assumptions for Calculation of Past Service Cost Per Active Employee*:

Liability	\$19,523,376
Employee Count	163
Cost/Employee	\$ 119,800
Less Buyout	\$ 40,000
Saving per Employee	\$ 79,800

<i>Scenario</i>	<i>Participation</i>	<i>Participants</i>	<i>Savings/Employee</i>	<i>Total Savings</i>
<i>A</i>	10%	16	\$ 79,800	\$1,276,800
<i>B</i>	20%	33	\$ 79,800	\$2,633,400
<i>C</i>	30%	49	\$ 79,800	\$3,910,200

* The above information is based on the May, 2008 Actuarial Valuation and should be verified by the actuary.



Legal Issues

- Constructive Receipt of the Buyout Offer
 - The choice of two nontaxable benefits does not create Constructive Receipt
- Discrimination Testing
 - Whether a plan meets nondiscrimination testing in any given year can depend on the percentage of participants in the plan and other factors that may fluctuate and therefore cannot be guaranteed in any given year



Required Components of HRA Program

- Program Implementation
 - Concept
 - Plan Design Structure
 - Actuarial and Consulting
- Administration
 - Ongoing Service
 - Manage Accounts
 - Recordkeeping



Required Components of HRA Program

- Financial
 - Investment Vehicle
 - Research
 - Ongoing Monitoring of Investment Plan Performance
 - Recommendations



Potential HRA Investment Vehicles

- Fixed Interest Investments
- Annuities
 - Fixed
 - Variable
- Mutual Funds
- Exchange Traded Funds (ETFs)
- Stocks and Bonds



HRA Plan Implementation

Sample timeline outlining the core steps to implement an HRA plan.

SAMPLE IMPLEMENTATION SCHEDULE

Week 1 Week 2 Week 3 Week 4

Decision to Hire MidAmerica

Plan Set-up

- Meet to finalize plan design
- Review Plan Documents
- Select investments
- Execute plan documents

Systems Set-up

- Meet with Payroll & IT
- Work through systems requirements
- MidAmerica plan set-up
- Test systems
- Implement

Employee Communications

- Meet to finalize communication strategy
- Schedule employee meetings
- Develop communication materials
- Send announcement
- Conduct employee meetings
- Implement



Keenan FutureFund Program



Why Keenan/FutureFund/CCLC?

- Community College League – Recognizing the need for Alternative Retiree Medical Programs
- Keenan & Associates – 950 clients in California, since 1972, with 10 offices throughout the state
- MidAmerica
 - Proven experience in HRA administration
 - Manages over 400,000 participant accounts
- AUL
 - Competitive pricing and investments
 - Over 90 joint clients in California



Next Steps

- Review current employee contracts
- Determine need for HRA program
- Provide information for a customized proposal
- Negotiations
- Create Timeline
- Communication
- Plan Implementation



Summary-*FutureFund*

- Defined contributions plans are not recognized as a GASB 45 liability
- Flexibility in Plan design
- “Turnkey” program
- Comprehensive education and support for the employer and the employee
- Experienced consultants to assist in all aspects of implementation
- Community College League sponsorship creates portability of **FutureFund** among all California CCDs



Thank You



Keenan
Associates

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