

A stylized map of Washington State is positioned on the left side of the slide, rendered in a light blue color against a dark blue background. The map shows the state's outline and major geographical features like the coast and the Cascade Range.

LEOFF Plan 2 Retiree Health Care

Initial Consideration – Follow Up

**WASHINGTON STATE
Law Enforcement Officers' and Fire Fighters'
Plan 2 Retirement Board**

October 26, 2005

Health Care Legislation Affecting LEOFF Plan 2

- Local Government employers not required to provide health care insurance to retirees.
- Local Government employers are required to make a “documented good faith effort” to provide health care insurance to retirees.

Health Care Legislation Affecting LEOFF Plan 2

- Requirements of “good faith effort” unclear
 - Documentation
 - Timeframes
- Access to health insurance provided to survivors of personnel killed in line of duty

Consumer Driven Health Accounts

| FEATURE | FSA | MSA | HRA | HSA |
|---------------|--|-----------------------------|--------------|------------------------------|
| Contributions | Employee Employer Both | Employee, or Employer | Employer | Employee Employer Both |
| Portable | No | Yes | Yes | Yes |
| Carryover | No | Yes | Yes | Yes |
| Tax Exempt | Contributions Qualified expenses | | | |
| HDHP | No | Yes | No | Yes |
| Limits | Employer Set | % of Ded | Employer Set | Ded or \$2600 |

Consumer Driven Health Accounts

| FEATURE | FSA | MSA | HRA | HSA |
|---------------|------------------------------|---------------------------------|-----------------|-----------------------------------|
| Contributions | Employee Employer Both | Employee, or Employer | Employer | Employee Employer Both |
| Limits | Employer Set | 65/75% of HDHP Deductible | Employer Set | Deductible or \$2600/\$5150 |

Questions?

Recent Retiree Health Care Legislation Affecting LEOFF Plan 2

Brief Summary

- Local government employers are not required to provide retired employees with health care insurance.
- Local government employers are required to “document a good faith effort” to provide access to health care insurance. What constitutes a “good faith effort” is not clearly defined and may be unclear to employers.
- The requirements for documenting a “good faith effort” and the required timelines for making a “good faith effort” are not specified and may be unclear to employers.
- Access to health insurance is provided to surviving spouses and dependent children of emergency service personnel killed in the line of duty. All benefit costs are paid by the surviving spouses and dependent children.

Background:

Permitting retired and disabled employees to obtain health insurance. Senate Bill 5777 (2002)

In 2002 the Legislature enacted legislation requiring political subdivisions to offer PERS covered retirees and disabled employees access to group health insurance coverage. This bill required that PERS covered employees who are retired or disabled from local government, who are not covered by the state Health Care Authority (HCA), to be allowed to continue participation in a health plan of their employer. Prior to this bill, local government employees in PERS not covered by HCA had no right under state law to continue to participate in the insurance plans of their employer after they retire or are disabled.

The bill provided exceptions and certain conditions under which the health care access must be provided. A local government could require a retired or disabled person who requires continued participation in its health plan to pay the full cost of such participation, including any amounts necessary for administration. Other conditions established in the bill included enrollment periods, coordination of benefits with a participant’s other employer-based medical coverage and coverage of dependents if the retired or disabled employee dies.

The legislation took effect on January 1, 2003, but local government employers were allowed up to one year from the effective date to come in compliance. The legislation established a mandate for the local government employers to offer access to health coverage, but did not require health carriers to offers such coverage. Following the passage of the legislation many health carriers declined to offer group policies for public retirees and disabled employees, and local government employers were unable to offer any alternatives to their retirees or disabled employees.

**Providing for individual health insurance for retired and disabled public employees.
House Bill 2985 (2004)**

In 2004 local government employers requested that the 2002 legislation be repealed due to the inability to comply with the legislation. In collaboration with employee representatives, the employers and bill sponsors agreed to make the requirement for providing retiree health care access conditional upon the employers ability to provide the required access rather than repealing the legislation. The new condition stated that an employer who could not comply with the provisions of the legislation were required to “document a good faith effort” to provide access to a fully insured group health benefit plan.

This bill amended the 2002 legislation so that PERS and LEOFF Plan 2 covered employees who are retired or disabled from local government and who are not covered by the state Health Care Authority (HCA) be allowed to continue participation in a health plan of their employer. However, the bill provided that if a local government employer is unable to offer access to group health insurance for their PERS and LEOFF Plan 2 retirees and disabled employees, despite a “documented good faith effort”, the local government employer’s obligation only extends to assisting the retirees and disabled employees in applying for individual health benefit plans.

Assistance may include developing standardized information on the availability and cost of individual health benefit plans, application packages, and benefit fairs. The Office of the Insurance Commissioner is also required to make available health benefit plan information, including a list of carriers that offer individual coverage, rates and how to apply.

The legislation provided no guidance on what constitutes a documented good faith effort. Moreover, the legislation does not provide any frequency or timeframe requirements for making a good faith effort. Although these issues were discussed in committee, no amendments were made to the bill. Thus it may be unclear to employers what needs to be documented and whether or not they have met their statutory obligation after one attempt to provide access.

**Health care access for survivors of emergency service personnel killed in the line of duty.
House Bill 1371 (2001)**

This bill requires the Public Employees Benefits Board (PEBB) to provide access to health insurance to surviving spouses and dependent children of emergency service personnel killed in the line of duty on or after January 1, 1998, including those who die as a result of injuries sustained in the course of employment as determined by the Department of Labor and Industries under Title 51 RCW. "Emergency service personnel" means members of the Law Enforcement Officers' and Fire Fighters' Retirement system and members of the Volunteer Fire Fighters' and Reserve Officers' Relief and Pensions system. All benefit costs are paid by the surviving spouses and dependent children.

Consumer Driven Health Accounts Summaryⁱ

October 26, 2005

Several options exist for employers to provide accounts that employees can use to pay for health care expenses not otherwise covered by a health plan; the options vary as to tax treatment, who can contribute, and what expenses can be covered.

There are four types of accounts that have received recent attention which can be used to help fund employee health care expenses:

- Flexible Spending Accounts (FSA)
- Medical Savings Accounts (MSA)
- Health Reimbursement Arrangements (HRA)
- Health Savings Accounts (HSA).

Flexible Spending Accounts (FSA)

Health care flexible spending accounts are employer-established benefit plans that reimburse employees for specified medical expenses as they are incurred. These accounts are allowed under section 125 of the Internal Revenue Code and are also referred to as "cafeteria plans" or "125 plans." Authorized by the Revenue Act of 1978, Flexible Spending Accounts became available January 1, 1979.

The employee contributes funds to the account through a salary reduction agreement and is able to withdraw the funds set aside to pay for medical bills. The salary reduction agreement means that any funds set aside in a flexible spending account escape both income tax and Social Security tax. Employers may contribute to these accounts as well.

There is no statutory limit on the amount of money that can be contributed to health care flexible spending accounts. However, some companies place a limit of \$2,000 to \$3,000 on flexible spending accounts. Once the amount of contribution has been designated during the open enrollment period that occurs once each year, the employee is not allowed to change the amount or drop out of the plan during the year unless he or she experiences a change of family status. By law, the employee forfeits any unspent funds in the account at the end of the year. There have been proposals introduced in Congress to ease this "use it or lose it" rule by allowing up to \$500 to be carried over to the next year; such proposals have not been enacted.

Funds can be used for un-reimbursed medical expenses as defined by Internal Revenue Code section 213 such as health care deductibles, co-payments, eligible non-prescription medications, and other items not covered by insurance. This excludes premiums for health insurance coverage and long-term care expenses.

Medical Savings Accounts (MSA)

Medical savings accounts are savings accounts used to pay for un-reimbursed health care expenses. These accounts can accumulate tax-deferred interest similar to individual retirement accounts (IRAs). Authorized by Title III of the Health Insurance Portability and Accountability Act of 1996, medical savings accounts became available January 1, 1997.

Funds are controlled and owned by the account holder. The employee or the employer--never both--makes contributions. In order to qualify, the employee must be covered by a high-deductible health insurance plan and must be self-employed or employed by a firm with 50 or fewer employees.

The maximum contribution to a medical savings account for single coverage is 65 percent of the deductible on the employee's health plan and 75 percent of the deductible for family coverage. For example, if an employee has a health plan with a deductible of \$2,225, then he is allowed to contribute a maximum of \$1,446.25 to a medical savings account for single coverage. With a family plan deductible of \$4,500, a maximum contribution of \$3,375 is allowed.

Savings are rolled over every year and are portable, regardless of employment status. Funds can accumulate earnings, which are not taxed unless funds are withdrawn for non-medical expenses.

Funds can be used on a pretax basis to pay for un-reimbursed medical care expenses as defined by Internal Revenue Code section 213, long-term care insurance premiums, health insurance premiums paid while unemployed, and COBRA premiums (for continuation of health insurance coverage available to formerly covered individuals under provisions of the Consolidated Omnibus Budget Reconciliation Act).

If withdrawn for non-medical purposes, savings are considered taxable income and are subject to income taxes in addition to a percent penalty tax. If the employee becomes disabled or reaches Medicare eligibility age, however, distributions for non-medical expenses from the account are subject only to ordinary income tax, not the penalty tax.

Health Reimbursement Arrangements (HRA)

Health reimbursement arrangements, also known as "health reimbursement accounts" or "personal care accounts," are a type of health insurance plan that reimburses employees for qualified medical expenses. The U.S. Department of the Treasury issued guidance on health reimbursement accounts in a revenue ruling in June 2002. Because these plans are just emerging, their designs are still evolving. Health Reimbursement Arrangements became available on June 26, 2002.

Health reimbursement arrangements are open to employees of companies of all sizes, unlike medical savings accounts that are only available for small business employees. A health reimbursement account provides "first-dollar" medical coverage until funds are exhausted. For example, if an employee has a \$500 qualifying medical expense, then the full amount will be covered by the health reimbursement arrangement if the funds are available in the account.

Health reimbursement accounts consist of funds set aside by employers to reimburse employees for qualified medical expenses, just as an insurance plan will reimburse covered individuals for the cost of services incurred. The guidance provided by the Department of the Treasury makes it clear that health reimbursement accounts are not a new type of account designated within the Internal Revenue Code. Rather, employers qualify for preferential tax treatment of funds placed in a health reimbursement account in the same way that they qualify for tax advantages by funding an insurance plan. (Employers can deduct the cost of an insurance plan -- and now a health reimbursement account -- as a business expense under Internal Revenue Code section 162.)

Under a health reimbursement account, the employer provides funds, not the employee. All unused funds are rolled over at the end of the year. Former employees, including retirees, can have continued access to unused reimbursement amounts. Health reimbursement accounts remain with the originating employer and do not follow an employee to new employment.

Health Savings Accounts (HSA)

Health Savings Accounts are tax-exempt trust or custodial accounts established exclusively for the purpose of paying or reimbursing qualified medical expenses. These accounts can accumulate tax-deferred interest similar to individual retirement accounts (IRAs). Authorized by the Medicare Prescription Drug Improvement and Modernization Act of 2003, medical savings accounts became available on January 1, 2004.

Health Savings Accounts are available to individuals who enroll in an high-deductible health insurance plan (HDHP), are not Medicare enrolled, are not covered by another health plan that is not an HDHP, and may not claimed as a dependent on another persons tax return.

Funds are controlled and owned by the account holder. The employee or the employer makes contributions. Savings are rolled over every year and are portable, regardless of employment status. Upon death, any remaining balance in the HSA becomes the property of the individual named in the HSA instrument as the beneficiary of the account.

Funds can accumulate earnings, which are not taxed unless funds are withdrawn for non-medical expenses. If withdrawn for non-medical purposes, savings are considered taxable income and are subject to income taxes in addition to a penalty tax. If the employee becomes disabled or reaches Medicare eligibility age, however, distributions for non-medical expenses from the account are subject only to ordinary income tax, not the penalty tax.

The maximum annual contribution to a HSA is the sum of the limits determined separated for each month, based on status, eligibility and health plan coverage as of the first day of the month. For calendar year 2004, the maximum monthly contribution for eligible individuals with self-only coverage under an HDHP is 1/12 of the lesser of the annual deductible under the HDHP (minimum of \$1000) but not more than \$2600. For eligible individuals with family coverage under an HDHP, the maximum monthly contribution is 1/12of the less of the annual deductible under the HDHP (minimum of \$2000) but not more than \$5150.

Funds can be used on a pretax basis to pay for qualified long-term care insurance premiums, health insurance premiums paid while unemployed, and COBRA premiums (for continuation of health insurance coverage available to formerly covered individuals under provisions of the Consolidated Omnibus Budget Reconciliation Act). In addition, for individuals over age 65, premiums for Medicare Part A or B, Medicare HMO, and the employee share of premiums for employer-sponsored health insurance, including premiums for employer sponsored retiree health insurance, can be paid from an HSA. Premiums for Medigap policies are not qualified medical expenses.

ⁱ Adapted from Health Spending Accounts by Haneefa T. Saleem, <http://www.bls.gov/opub/cwc/print/cm20031022ar01p1.htm>, Viewed 1/25/04

**Consumer Driven Health Accounts
Comparison of Key Features
October 26, 2005**

| | Flexible Spending Account (FSA) | Medical Savings Account (MSA) | Health Reimbursement Arrangements (HRA) | Health Savings Accounts(HSA) |
|--|---|---|---|---|
| Establishment Of Account | <ul style="list-style-type: none"> • Employer-sponsored Benefit Program via Cafeteria Plan | <ul style="list-style-type: none"> • Self-employed Individual • Small Employer (50 or fewer Employees) | <ul style="list-style-type: none"> • Employer-sponsored Benefit Program | <ul style="list-style-type: none"> • Eligible Individual • Employer • Integrate with Employer-sponsored cafeteria plan |
| High Deductible Health Plan (Hdhp) Required | No | Yes | No | Yes |
| Eligibility | <ul style="list-style-type: none"> • Employee who meets Employer's Eligibility Criteria | <ul style="list-style-type: none"> • Eligible Individual • Eligible Employee covered by a HDHP | <ul style="list-style-type: none"> • Employee who meets Employer's Eligibility Criteria | <ul style="list-style-type: none"> • Eligible Individual covered by HDHP • Eligible Employee covered by HDHP |
| Funding | <ul style="list-style-type: none"> • Employee Salary Reduction Dollars • Employer | <ul style="list-style-type: none"> • By Individual OR • By Employer | <ul style="list-style-type: none"> • Strictly by Employer | <ul style="list-style-type: none"> • Individual • Employee salary reduction dollars • Employer |
| Account Limits | No statutory required limit | Individual <ul style="list-style-type: none"> • 65% of Deductible Amount Family <ul style="list-style-type: none"> • 75% of Deductible Amount | No statutory required limit | Individual -- <i>Lesser of</i> <ul style="list-style-type: none"> • Deductible Amount; or, \$2,600 Family -- <i>Lesser of</i> <ul style="list-style-type: none"> • Deductible Amount ; or • \$5,150 |
| Annual Out Of Pocket Limits | n/a | <ul style="list-style-type: none"> • \$3,450 Individual • \$6,300 Family | n/a | <ul style="list-style-type: none"> • \$5,000 Individual • \$10,000 Family |
| Qualified Medical Expenses | <ul style="list-style-type: none"> • Qualified Medical Expenses as defined in IRC §213(d), including over-the-counter drugs <p><i>Not permitted:</i></p> <ul style="list-style-type: none"> • Health insurance premium, including LTC insurance premium | <ul style="list-style-type: none"> • Qualified medical expenses as defined in IRC §213(d), including over-the-counter drugs • COBRA premium • LTC insurance premium • Health insurance premium, if receiving unemployment | <ul style="list-style-type: none"> • Qualified medical expenses as defined in IRC §213(d), including over-the counter drugs • Health insurance premium, including LTC premium | <ul style="list-style-type: none"> • Qualified medical expenses as defined in IRC §213(d), including over-the-counter drugs • Retiree health insurance premium other than Medicare supplement policies • COBRA premium • Long term care (LTC) insurance premium • Health insurance premium if receiving unemployment <p><i>Not permitted:</i></p> <ul style="list-style-type: none"> • Any other type of health insurance premium |

| | Flexible Spending Account (FSA) | Medical Savings Account (MSA) | Health Reimbursement Arrangements (HRA) | Health Savings Accounts(HSA) |
|---|--|--|---|---|
| Tax Treatment Of Contributions | <ul style="list-style-type: none"> • Employee Contributions to Employee's own FSA are pre-tax • Employer-Contributions to employee's FSA: <ul style="list-style-type: none"> - Deductible by Employer - Excludable from Employee's gross income | <ul style="list-style-type: none"> • Individual's contributions to MSA are tax-deductible • Employee Contributions to Employee's own MSA are tax-deductible • Employer-Contributions to Employee's MSA <ul style="list-style-type: none"> - Deductible by Employer - Excludable from Employee's gross income | <p>Only Employer Contributions permitted:</p> <ul style="list-style-type: none"> • Deductible by Employer • Excludable from Employee's gross income | <ul style="list-style-type: none"> • Individual's contributions to own HSA tax-deductible • Employee-Contributions to Employee's own HSA are Tax-Deductible • Employer-Contributions to Employee's HSA with salary reduction dollars: <ul style="list-style-type: none"> - Deductible by Employer - Excludable from employee's gross income |
| Taxation Of Interest Accumulation | n/a | Tax-free | n/a | Tax-free |
| Consequences Of Cashing-Out Account For Non-Qualified Medical Expenses | <ul style="list-style-type: none"> • No cash-out option available | <ul style="list-style-type: none"> • Distributions are taxed as income and subject to 15% penalty tax • No penalty tax after age 65, but subject to income tax | <ul style="list-style-type: none"> • No cash-out option available | <p>Distributions are taxed as income and subject to 10% penalty tax, except following:</p> <ul style="list-style-type: none"> • Death • Disability • Attainment of Medicare eligibility age |
| Carry-Over Of Funds to Next Year | No | Yes | Yes | Yes |
| Portability | <ul style="list-style-type: none"> • Account cannot be maintained if the employee is no longer working for the employer | <ul style="list-style-type: none"> • Continued access to unused account balance if the employee is no longer working for the employer | <ul style="list-style-type: none"> • At employer discretion | <ul style="list-style-type: none"> • Continued access to unused account balance if the employee is no longer working for the employer |
| Death Of Account Holder | <ul style="list-style-type: none"> • Eligible Dependents entitled to use remaining account monies for qualified medical expenses, in accordance with the plan document | <ul style="list-style-type: none"> • Surviving spouse only (if designated beneficiary) entitled to use remaining account monies for qualified medical expenses | <ul style="list-style-type: none"> • Eligible Dependents entitled to use remaining account monies for qualified medical expenses, in accordance with the plan document | <ul style="list-style-type: none"> • Surviving spouse only (if designated beneficiary) entitled to use remaining account monies for qualified medical expenses |
| Subject To Cobra | Yes | No | Yes | <ul style="list-style-type: none"> • No, if not Employer-based • Unclear, if Employer-based |
| Effective Date | 1/1/79 | 1/1/97 | 6/26/02 | 1/1/04 |
| Initial Legislation | Revenue Act of 1978 | Health Insurance Portability and Accountability Act of 1996 | U.S. Department of the Treasury Revenue Ruling 2002-41 | Medicare Prescription Drug Improvement and Modernization Act of 2003 |
| Internal Revenue Code Reference | IRC Section 125 | IRC Section 106(b) | IRC Sections 105-106 | IRC Section 223 |

