Objectives

Provide information that will help School Districts develop or transition to the most efficient retiree and early retiree medical benefit.

Support Board of Education decisions with accurate, effective legal and financial analysis and information.

Transition

What is changing for School District retiree and early retiree medical benefits?

• Aging and Retiring Population:
  • Largest cohort of employees entitled to retire
  • Early retiree medical and OPEB benefits are now retiring and are eligible for their benefit.
  • Continuing situation for 30+ years.
  • Six (6) % of health plan participants account for 47 % of plan cost.

Transition

- Retiree/early retiree and OPEB benefits were structured under a defined benefit model in collective bargaining agreements. The employer pays the benefit for the beneficiary’s lifetime.

- New tax-favored options and tools allow a transition to a defined contribution benefit where the School District pays a percentage or fixed amount into an account. More predictable and easier to fund.

Overview

- Plan options
- Funding
- Investments
- Other considerations

Key Points

➢ School Districts can outsource many OPEB plan obligations including recordkeeping, investment management and the fund custodian role but the School District remains the OPEB plan sponsor and fiduciary under Wisconsin law and the Internal Revenue Code.

➢ Income earned in a Section 115 Government Trust is an asset of the government employer and may not benefit “private interests.”

➢ Assets held in a Section 115 or other government trust must be segregated by plan within the trust.

➢ Wisconsin’s authorizing statute § 66.0603 requires School Districts to comply with Wisconsin’s Uniform Prudent Investor Act (Wis. Stat. §881.01) when holding OPEB funds in trust.
Intersecting legal obligations include:

- Internal Revenue Code tax qualification requirements
- Financial reporting under GASB 67, 68 and 73 (Pensions) and GASB Statements 74 and 75 (OPEB)
- U.S. Department of Labor health insurance requirements (PHSA) including COBRA
- Affordable Care Act payroll reporting obligations and retiree plan exemption
- Wisconsin law on School District OPEB and non-OPEB fund investments

Retiree Medical Plan Options:

- School District active employee group health plan continuation as a retiree.  
  Note – Keeping retirees in the active plan may affect premium cost for the fully funded plan or for stop loss coverage in a self-insured plan.
- School District-sponsored retiree group health plan.
- Bridge to Medicare for early retirees.
- Ending health plan participation – making a COBRA offer at retirement.

Retiree Medical Plan Funding Options:

- "Pay as you go"
- Retiree Health Reimbursement Arrangement (HRA)
- Retiree Health Savings Account (HSA)
- Deferred PTO Account
- Non-elective 403(b)/TSA contributions
- Medicare
- Individual Marketplace Plans
Retiree Medical Plan Funding Options:

**Funding considerations**

**Underfunding** – how to use available options to maximize funding potential

- Tax-preferred plans, trusts and investments
- Front-loaded funding to maximize earnings
- BUT watch investment quality/management and plan’s asset-based fees

**Overfunding** – how to use available options to avoid losing aid

- Plan assets are greater than accrued obligation
- Transfer some OPEB assets to a retirement plan

 Kimberly Area School District case study

---

**Plan Funding Options:**

**Current** - "Pay as you go"

- From general operating funds as the liability becomes due.
- Subject to revenue variations year to year.

---

**Plan Funding Options:**

**Defined Benefit - Current**

- Insurance stipend - Pay all or some portion of retiree insurance (from any source) until Medicare eligibility.
- School District plan participation as retiree - Keep retiree and dependents in the School District active employee group health plan or create an equivalent School District-sponsored retiree group health plan. Covered to Medicare eligibility or beyond.
- Impact on Medical Trend (Implicit Rate Subsidy): No direct "cost" to the School District to keep retirees in the group health plan but can increase the cost of the plan to the School District over time and the implicit rate subsidy must be actuarially reported.
Plan Funding Options:

**Funded Retiree Health Reimbursement Arrangement (HRA)**

A. Retiree HRA is a tax-exempt, employer-funded, self-insured medical reimbursement plan.

B. Affordable Care Act (ACA) requires Minimum Essential Coverage (MEC) reporting for retiree participants.

C. Requires a plan document. Funds can be used for deductibles, unreimbursed costs and premiums.

D. COBRA continuation is required for active employee HRA qualifying event but not when retiree HRA participation ends.

E. Retiree HRA can be funded with employer contributions or a mandatory PTO conversion. See, PLR 201528004.

F. PTO conversion is tax-exempt and allows for School District FICA exemption on the converted contribution amount.

G. Rollover of active employee HRA funds to Retiree HRA account appears to be acceptable; no real IRS guidance. Risk management would include reverting active employee HRA funds back to employer and then contributing the amount to the Retiree HRA.

H. Retiree HRA can only be used by a former employee who has retired from the School District.
Plan Funding Options:  
**Funded Retiree Health Reimbursement Arrangement (HRA)**

**Option advantages**
- Retiree HRA funds are fully-tax-exempt for the employee, retiree and the School District when used for qualified expenses.
- Individual medical costs in retirement are predicted to be $280,000 on average.
- Retiree HRA has no contribution limit.
- Can be funded in part or fully with deferred PTO, employer contribution and active employee HRA rollover.
- Can be layered with 403(b) and other retirement accounts without exceeding contribution limits.
- When pre-funded with PTO and/or School District contributions held in trust, liability can be removed from Fund 73 yet state aid is available on the amounts.
- When pre-funded, earnings and interest held in the trust are an asset of the School District and can be used to reduce the School District’s net liability.
- HRA accounts do not have to be funded annually. The accounts can be credited monthly, quarterly or on another regular calendar basis.

**Option limits**
- HRA contributions are subject to non-discrimination testing; cannot benefit highly compensated employees over other plan participants.
- School District cannot make individualized HRA contributions (e.g., an individual contractual contribution) to a particular employee’s account. The HRA is a qualified group medical plan.
- Retiree HRA plan participants receive minimum essential coverage under the Affordable Care Act and must be reported on the School District’s Form 1094-C.
- Retiree HRA plan participants must be retired. If School District retirees are rehired, their Retiree HRA plan participation must be suspended until they re-retire to avoid disqualifying the Retiree HRA under the Affordable Care Act.

Plan Funding Options:  
**Retiree Health Savings Account (HSA)**

- Retiree HSA is a retiree medical expense savings account.
- Retiree HSA does not require a plan document but must be offered in conjunction with an individual or group High Deductible Health Plan.
- School District can contribute to a Retiree HSA during active employment but employer contribution is not required.
- School District’s HSA benefit can treat retirees as a separate contribution class.
- Fully portable after employment ends, can be used to reimburse any qualified medical expense.
- COBRA continuation rules do not apply to Retiree HSA plan participation.
Plan Funding Options:

**Deferred Paid Time Off (PTO) Escrow Account**

A. Irrevocable PTO deferral before constructive receipt under individual employment agreement, employee handbook, collective bargaining agreement or Board of Education policy.

B. Deferred time is never paid to the employee but also is not a salary deferral requiring cafeteria plan coverage.

C. School District maintains a record of deferred time value and credits retiree medical account at retirement or annually if the deferral occurs before the year earned.

D. Watch for constructive receipt of accrued PTO time. Can be taxable to the employee if it is available, even if the time is not taken. Deferral must occur before the time is available to the employee either at the employee’s hire date or, if annually, the month before the accrual year begins.

Plan Funding Options:

**Non-elective 403(b)/TSA Contributions**

A. School District makes contributions to employee’s 403(b) plan account during active employment, at retirement, during the five years following retirement or spread out over some combination of these timing events.

B. FICA is collected on post-employment non-elective contributions to employee accounts and funds are subject to income tax at distribution but may be tax deductible for medical expenses that exceed 7.5% of AGI (in 2017/18).

C. Requires a plan document.

Plan Funding Options:

**Can a School District help to fund Medicare coverage?**

A. Employer contributions to a non-elective 403(b) plan can be used toward Medicare supplemental plan costs and/or other expenses not reimbursed by Medicare.

B. Reimbursing the cost of a Medicare supplemental plan from Retiree HRA or HSA is acceptable.


D. COBRA continuation may apply to group health plan participation even after Medicare eligibility.
Plan Funding Options:

Individual Marketplace Plans

A. School District cannot subsidize individual Marketplace plan enrollment with cash payment.

B. Retiree HRA can reimburse individual Marketplace plan costs but retiree may lose the chance to receive a premium tax credit. The School District should obtain a premium tax credit waiver from early retirees.

Plan Funding Mechanics:

Pre-funding

Benefit Plan (including plan document)
Funds
Trust Account to hold the Funds
- Trustee
  - Trust Agreement in which the Trustee agrees to hold the Funds as Trustee
- Tax-qualification to ensure interest and earnings accrue with tax liability
Registered Investment Company
- TPA/Claims Administrator
- Recordkeeper
- Actuary

Financial Reporting:

Case Study – Kimberly Area School District

Moving from OPEB funding to actively pre-funded Retiree HRA contributions.

Moving from funding OPEB for health insurance to actively funding a TSA.
Financial Reporting:

Case Study – Kimberly Area School District

A. Employees that were hired before 2011 are currently eligible for health insurance benefit as well as a premium only HRA based on years of service.

B. In order to maximize our aid being a highly aided district and assure that this benefit will be funded in the future, we changed the HRA from funding it as part of our OPEB costs to actively funding it each year based on what our employees have earned.

Financial Reporting:

Case Study – Kimberly Area School District

A. Employees that are hired after 2011 no longer receive the health insurance benefit or HRA.

B. They are eligible for an annual contribution to a TSA that earns interest each year until they are eligible for retirement and withdraw the funds.

C. The intent is for this money to be used for health insurance costs in retirement and, as Julie mentioned, maybe tax deductible.
Anatomy of a School District Retiree Medical Plan

Plan Funding Mechanics:

**Trust Account**

Section 115 Trust

Trust account qualified under section 115 of the Internal Revenue Code as a government trust. Does not require a pre-determination letter if the trust meets all applicable requirements.

Voluntary Employees’ Beneficiary Association (VEBA)

Trust account qualified as a tax exempt trust under section 501(c)(9). Requires a pre-determination letter.

**401(h) Trust Account**

Retiree medical account that is part of a defined benefit pension plan. Also requires a pre-determination letter.

Plan Funding Mechanics:

Pre-funding – Section 115 Trust

A. 26 U.S.C. § 115(a);
B. Gross income does not include – (1) income derived from any public utility or the exercise of any essential governmental function and accruing to a State or any political subdivision thereof, or the District of Columbia, or (2) income accruing to the government of any possession of the United States, or any political subdivision thereof;
C. A trust exists under the Internal Revenue Code if a court in the United States is able to have primary supervision of the administration of the trust. Must be a separate legal entity. 26 U.S.C. § 7701(a)(30);
D. An arrangement will be treated as a trust under the Internal Revenue Code if the purpose of the arrangement is to vest the trustee with the responsibility for the trust assets for beneficiaries who cannot share the trustee’s oversight responsibilities. If the beneficiaries share or perform as trustee, they become associates in a joint enterprise for the conduct of business for profit. 26 C.F.R. § 501.4(a).
Plan Funding Mechanics:
**Pre-funding – Section 115 Trust**

Separate entity
Integral part of government

Performing an essential government function

A. Income earned by an enterprise that is an integral part of a government entity is not taxable. Rev. Rul. 77-261, 1977-2 C.B. 45 says:

The investment of positive cash balances by a State or political subdivision thereof (as a separate entity) in order to receive some yield on the funds until needed to meet expenses is a necessary incident of the power of the State or political subdivision to collect taxes or other revenues for use in meeting governmental expenses. The investment of funds by a State or political subdivision in an investment fund of the kind involved in this case constitutes the exercise of an essential governmental function for purposes of section 115(1) of the Code.

Plan Funding Mechanics:

**Pre-funding – Section 115 Trust**

Providing a retiree medical benefit is essential government function.

Trust holding pre-funding contributions must be irrevocable, separate from the government entity and dedicated to the public benefit.

C. There can be no benefit to any private interest. Even the benefit to retirees and their families is defined as incidental to the public benefit. Prefunded trust assets belong to the government entity (e.g., the taxpayers) and can be invested only as permitted by state law. See, PLR 2015-16031; Wis. Stat. § 66.0603.
Plan Funding Mechanics:

Pre-funding – Section 115 Trust

Trust characteristics:

A. Separate entity with separate governance.
B. Funds held by Trustee pursuant to a Trust Agreement.
C. Trust performs an essential government function – funding retiree medical/OPEB plan costs.
D. Trust can be:
   • A group trust or
   • Individual School District section 115 trusts whose assets are pooled for investment purposes.

Individual pooled trusts can be a better option because OPEB trust participants avoid imbalance between participants with small asset amounts and those with large asset amounts that will obtain a greater share of the earnings.

Plan Funding Mechanics:

Pre-funding – Section 115 Trust

Trust characteristics:

E. Interest and earnings accrue on a tax exempt basis if they are used exclusively for a government purpose.
F. Forfeitures remain in the trust and revert to the School District.
G. Subaccounts (e.g., retiree HRA, non-elective 403(b)) cannot be commingled or used interchangeably.

Plan Funding Mechanics:

Investments


B. A School District may invest OPEB funds held in trust when:
   • The funds are held in a trust that is separate from all other trust funds created by or under control of the Board of Education.
   • The funds are invested as required under the Wisconsin Uniform Prudent Investor Act, Wis. Stat. §881.01.

C. A School District may delegate investment authority to a bank or trust company registered in Wisconsin or a registered investment advisor who meets the requirements of the trust’s investment policy. Wis. Stat. §66.0603 (2)
Plan Funding Mechanics: Investments

E. The School District may not establish an OPEB trust unless the notice of the school board meeting at which the discussion or vote may occur includes a separate agenda item for the discussion and/or vote. Wis. Stat. § (1m)(4).

F. The Board of Education must review annually the investment agreement and the performance of the investment manager. Wis. Stat. § (2)(b).

Plan Funding Mechanics: Investments

Wisconsin Uniform Prudent Investor Act, Wis. Stat. § 881.01 requires School Districts, as plan sponsors and fiduciaries, to:

• Follow the "Prudent Investor" rule – investing and managing assets as a prudent investor would, considering the purposes of the assets and exercising reasonable skill, care and caution.
• Diversify investments.
• Exercise the duties of loyalty solely to the beneficiaries and impartiality.
• Incur only costs that are appropriate and reasonable in relation to the assets. Compliance is determined based on the facts and circumstances at the time. There is no benefit of hindsight.

Plan Funding Mechanics: Investments – Plan costs

Internal Revenue Code section 115 guidance also requires plan fees to be paid as reasonable administrative costs.

Anything more than a reasonable fee could be seen as allowing a benefit to a private interest which could impact the section 115 trust’s tax exemption on earnings and interest.
School District Fiduciary Obligations:
Things to remember -

A. Service Provider Contracts – Administrative Service Agreements will assign fiduciary obligations to the school district.

B. ERISA standards will probably apply if there is a dispute even though the plans are not covered by ERISA.

School District Fiduciary Obligations:
Things to remember -


D. Employment tax rules

E. Rehiring retirees – retiree HRA rules

F. Participant notices

Other considerations:

G. Age Discrimination in Employment Act (ADEA) – encourage/discourage early retirement

H. Classification – uniform treatment within retiree medical benefit plan participant classes

I. Former employees/retirees - HSA option

J. Non-elective contributions v. salary reduction replacement
Key Points

➢ School Districts can outsource many OPEB plan obligations including recordkeeping, investment management, and the fund custodian role, but the School District remains the OPEB plan sponsor and fiduciary under Wisconsin law and the Internal Revenue Code.

➢ Income earned on a Section 115 Government Trust is an asset of the government employer and may not benefit “private interests.”

➢ Assets held in a Section 115 or other government trust must be segregated by plan within the trust.

➢ Wisconsin’s authorizing statute § 66.0603 requires School Districts to comply with Wisconsin’s Uniform Prudent Investor Act (Wis. Stat. § 881.01) when holding OPEB funds in trust.

Julie A. Lewis
Strang, Patteson, Renning, Lewis & Lacy, s.c.
660 W. Washington Ave., Ste 303
Madison, WI 53703
(608) 333-0967
jlew@strangpatteson.com
www.strangpatteson.com

Rebecca Hansen
Director of Business Services
Kimberly Area School District
rhansen@kimberly.k12.wi.us
Direct phone: 920-423-4134
District phone: 920-788-7900