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Taking Public Sector Retiree Medical to the Next Level

Faced with the sobering reality of more than $1 trillion in unfunded retiree healthcare liabilities, public sector employers across the country are seeking a sustainable retiree health benefit solution. Their shift to relying on retiree health insurance exchanges will not be without challenges or concerns. One solution that is just starting to be used is to work with state legislatures and make benefit changes that allow public sector employees to convert unused sick leave into retiree health insurance credits.

Numerous plan sponsors for public sector organizations may already be using – or contemplating the use of -- retiree healthcare insurance exchanges to facilitate purchase of pre-65 individual policies or Medicare supplemental benefits. As public sector employers review this option, they should consider issues that may arise if future cuts are made to retiree medical stipends. What will be the exchange based solution?

Earlier this year, the *Ohio Public Employees Retirement System (OPERS)* announced that serious financial pressure will result in significant reductions in stipends for retiree health benefits. The cuts for pre-65 retirees may be as much as $400 per month and will affect retirees including police and fire department pensioners. Although the mandatory retirement age for a public safety officer may be 65, many police officers and firefighters retire well ahead of Medicare entitlement, because of health status and long service.

According to a January 16, 2020 *cleveland.com article,* the changes will reduce OPERS unfunded healthcare liabilities from $6.2 billion to $27 million. Officials from OPERS said the $11 billion healthcare fund was set to run out of money in 11 years, but with the changes that will be implemented beginning in 2022, the fund will be solvent for 18 years.

In addition to cutting premium subsidies for retirees in 2022, healthcare coverage will no longer be provided through OPERS. Retirees will receive an OPERS subsidy to be used toward the purchase of healthcare coverage through the healthcare marketplace.

Look beyond HSAs

It is evident that there is an acute need for public sector employers to accumulate funds for retiree medical benefits while the plan participant is actively employed. While Health Savings Accounts (HSAs) provide an opportunity for employees to create a nest egg, implementing a qualified high deductible health plan for collectively bargained public sector groups remains a challenge. In addition, these high deductible plans are not immune to problematic healthcare trends, including how high cost specialty drugs can ravage an employer’s (and employee’s) health benefits budget.

An alternative to an HSA, Health Reimbursement Accounts (HRAs) do not need to be paired with a high deductible plan, but the employer contributions are typically modest and easily consumed by out-of-pocket medical, prescription drug, dental and vision expenses. For instance, according to Mercer’s 2018 National Survey of Employer Sponsored Health Plans, the median HRA annual contribution for those with single coverage was just $625.

A better mechanism is needed to establish funds for public sector retiree medical benefits – and the states of New York and Wisconsin may be on the right track. New York’s policy allows eligible state employees to cover some retiree health insurance costs with unused sick leave, while in Wisconsin, the Accumulated Sick Leave Credit Conversion Program allows state employees covered by the State Group Health Insurance Program to convert unused sick leave into credits to pay for health insurance when they retire. The credits cannot earn interest or be used to pay for insurance that is not part of the State Group Health Insurance Program.

Since most employers, public sector and private, are interested in reducing health care liabilities and not subsidizing retirees under their active employee health benefits plan, the Wisconsin approach – with some important tweaks -- is an intriguing solution that should be considered in other states.

Retiree medical's future: Sick leave conversion, HRAs and marketplace options?

First, the decision to convert unused sick leave into health insurance credits should be left to each retiring employee without triggering a taxable event. In 2005, the Internal Revenue Service (IRS) issued *Revenue Ruling 2005-24* that allowed employers to use sick leave and vacation conversion programs to fund an HRA, as long as the employees did not have the option to take these converted amounts in cash. Then, in 2007, the IRS issued a Private Letter Ruling (*PLR 200708006*) indicating the sick leave and vacation conversion arrangement did not result in taxable income if the employer mandates what unused amounts would be converted to cash, contributed to the HRA, or used to pay other benefits.

In other words, the employee has no say in any of these important decisions.

Second, the retiree should not be forced into remaining in their former employer's group health plan. They should have the ability to shop the insurance marketplace for a plan and medical provider network that meets their needs.

Third, the retiree should be able to decide how to spend the HRA funds. Even the new Excepted Benefit HRA unveiled last year by the Trump administration (where up to $1,800/year may be contributed by the employer) does not allow the HRA to be used to pay premiums for Medicare Parts B or D; individual health insurance (except for short-term limited duration insurance); group insurance coverage (except COBRA); or Medicare supplements or Advantage plans.

Although a traditional HRA or Retirement HRA may allow payment of premiums for Medicare of long-term care insurance; and if using a trust, accept employee/retiree after-tax contributions and accrue interest tax-free, there is still the issue that conversions of unused sick leave must be made on a mandatory basis by the employer. The employee cannot make such an election before retirement.

As state legislatures consider strategies to deal with the ever growing costs of providing retiree healthcare, the option of new legislation that would permit state and local governments to create sick leave conversion programs that would enable their retirees to use those funds to help pay for health insurance purchases on or off an insurance exchange. To give employees more control over the conversion to credits, there would have to be some changes to the employer's *IRC 125 cafeteria plan*. The approach could provide a more sustainable bridge to Medicare for those public sector employees who retire before age 65.

We are interested in your thoughts about this topic. Please contact Bruce Davis with your questions and comments at *Bruce.Davis@findley.com* or *419.327.4133*